STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

MidAmerican Energy Company	**:**	
	:	
Proposed general increase for	**:**	**Docket No. 14-0066**
Electric service	**:**	

MidAmerican Energy Company's Initial Brief

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INITIAL BRIEF
OF
MIDAMERICAN ENERGY COMPANY

NOW COMES MidAmerican Energy Company ("MidAmerican") and respectfully submits its Initial Brief pursuant to the Administrative Law Judge's Notice of Continuance of Hearing and Notice of Schedule of February 24, 2014, in the above-captioned proceeding.

I. INTRODUCTION

Overview of Requested Increase

MidAmerican is a multijurisdictional utility engaged in generating, transmitting and distributing electricity and distributing natural gas in the Illinois Quad City area as well as in portions of Iowa, South Dakota, and Nebraska. MidAmerican's current Illinois electric rates are the result of long-term rate stability for our customers. MidAmerican offers bundled retail electric rates and delivery service rates. MidAmerican Ex. DAC 1.0, at 4, ll. 32-64. The last electric rate increase for bundled electric service was over 20 years ago in 1992.

After 1992, there were two electric rate decreases resulting from the implementation of the Commission's decision in Docket No. 96-0510, one in 1996 of approximately 13.3% and another in 1998 of approximately 1.7%. Delivery service rates were adopted for MidAmerican in Docket Nos. 99-0122/99-0130 and 01-0444. *Id.*, ll. 64-69.

On December 16, 2013, MidAmerican filed a proposed increase in its rates for electric service. MidAmerican proposed an increase in electric rates of approximately $21.6 million or 16.9% over 2012 revenues. Current base electric rates are based on mid-1990s business-related expenses and need to be updated to reflect new investments and increases in expenses to maintain and operate generation and delivery facilities. For example, from 1995 to 2012 the following business categories have experienced the following increases:

- Generation plant - $108 million (+42%)
- Transmission and distribution structures and stations – $170 million (+99%)
- Transmission and distribution operation and maintenance expense – $10.6 million (+140%)

MidAmerican Ex. DAC 1.0 at 11-12, ll. 107-112.

Procedural History

MidAmerican filed new tariff sheets identified as Ill. C. C. No. 10, hereinafter referred to as "Filed Rate Schedule Sheets," on December 16, 2014, by which MidAmerican proposed a general increase in electric rates, effective February 1, 2014.

Notice of the filing was posted in public and conspicuous places in MidAmerican's commercial office in Moline, Illinois and published twice in newspapers of general circulation throughout MidAmerican's electric service area, in accordance with the requirements of Section 9-201(a) of the Public Utilities Act ("Act") (220 ILCS 5/9-201(a)) and the provisions of 83 Ill. Adm. Code 255.

An examination of the Filed Rate Schedule Sheets resulted in a determination by the Illinois Commerce Commission ("Commission") to enter upon hearings concerning the propriety of the proposed general increase in electric rates and that, pending hearings and a decision thereon, the Filed Rate Schedule Sheets should not be allowed to become effective. On January 23, 2014, the Commission entered an Order suspending the Filed Rate Schedule Sheets to and including May 16, 2014. On May 7, 2014, the Commission resuspended the Filed Rate Schedule Sheets to and including November 16, 2014.

By letter dated January 17, 2014, from the Administrative Law Judge ("ALJ"), MidAmerican was notified of certain deficiencies in its filing in accordance with 83 Ill. Adm. Code 285, Standard Filing Requirements for Electric, Gas, Telephone, Water and Sewer Utilities in Filing for an Increase in Rates. The deficiency letter required MidAmerican to provide various revised and additional schedules or an explanation as to why certain schedules need not be provided. MidAmerican provided information responsive to the deficiency letter on February 14, 2014. There are no outstanding deficiencies and MidAmerican has complied with all other Standard Filing Requirements for electric utilities.

Petitions to Intervene were filed by Deere & Company ("Deere") on March 19, 2014, and by the Department of Defense ("DOD") on March 21, 2014. The Petitions to Intervene were granted on June 24, 2014.

Pursuant to notice given in accordance with the law and the rules and regulations of the Commission, this matter came on for hearing before a duly authorized ALJ of the Commission at its offices in Chicago, Illinois on June 24, 2014. Appearances were entered by counsel on behalf of MidAmerican, Staff of the Commission ("Staff"), Deere and DOD.

At the evidentiary hearings, eight witness on behalf of MidAmerican, and three witnesses on behalf of Staff, presented testimony and exhibits. The parties stipulated into evidence the remaining pre-filed testimony and exhibits. On June 24, 2014, the ALJ marked the record "Heard and Taken."

The procedural schedule calls for MidAmerican, Staff, Deere, and DOD to file Initial Briefs on July 22, 2014 and Reply Briefs on August 7, 2014.

The record in this case consists of the transcript, pre-filed written testimony and other exhibits. The record contains a detailed analysis of MidAmerican's operations, including MidAmerican's operating revenues and expenses, the original cost and accumulated depreciation of the Company's property, and the cost of capital and other matters relating to the appropriate rate of return and revenue requirement for MidAmerican.

II. Test Year

For the test year in this proceeding, MidAmerican selected a historic test year consisting of the 2012 calendar year with pro forma adjustments. MidAmerican Ex. RRT 1.0 at 4, ll. 48-51; MidAmerican Ex. RRT 3.1, Sch. C-1- Surrebuttal. No party objected to the test year selected by MidAmerican. The proposed test-year is reasonable and is uncontested.

III. Rate Base

A. Overview

MidAmerican Schedule B-1 Surrebuttal summarizes MidAmerican's Company's electric rate base. The adjusted rate base reflected on the schedule is $334,836,000. As discussed below, none of the parties objected to MidAmerican's proposed rate base pro forma adjustments relating to the non-Illinois electric rate base, plant additions, and depreciation adjustments. MidAmerican Ex. MAJ 2.0, at 3, ll. 29-35, *see also* MidAmerican Schs. B-2.1 through B-2.10 and Schs. B-2.11 through B-2.13.

While MidAmerican does not necessarily agree with the rationale for Staff's adjustments and reserves the right to rebut similar positions in future cases, in the interest of narrowing the issues in this case, MidAmerican agreed to accept Staff's material and supplies A/P adjustment and adjustments to cash working capital. *See* Staff Ex. 1.00, Sch. 1.04, column (d). After accepting these proposed adjustments, MidAmerican's proposed Illinois jurisdictional original cost rate base is $334,836,000. MidAmerican Ex. MJA 3.1, Sch. B-1 Surrebuttal.

Staff, however, proposes further rate base adjustments to incentive compensation, payroll taxes and pension costs associated with incentive compensation, and the pension asset. As described in detail below, the Commission should reject these proposals. Accordingly, the Commission should approve the MidAmerican's proposed 2012 test year rate base, as adjusted in rebuttal and surrebuttal testimony and reflected on MidAmerican Exhibit MJA 3.1, Sch. B-1 Surrebuttal, line 21, column (e).

B. Uncontested adjustments to MidAmerican's proposal

1. <u>Utility Plant in Service – Illinois Allocation for Change in Plant in service and accumulated depreciation</u>

Staff and MidAmerican agree on the proposed rate base pro forma adjustments relating to the non-Illinois electric rate base, Neal 3 environmental, Neal 4 environmental, railcar purchased, OGS – AQCS emission control, Neal 4 outage, sub 48 Silvis transformer, Colona 69-13 kV substation, Neal 3 air heater replacement, OGS CAMP projects, Neal 1 & 2 life change and the depreciation adjustments summarized on MidAmerican Schs. B-2.1 through B-2.10 and B-2.11 through B-2.13 included as part of the filing requirements. MidAmerican Ex. MJA 2.0, at 3, ll. 29-35; *see also* MidAmerican Ex. STM 1.0. Accordingly, the adjustments are reasonable, uncontested and MidAmerican requests that the Commission adopt the pro forma adjustments related to utility plant in service and depreciation.

2. <u>Cash Working Capital</u>

Cash Working Capital ("CWC") is the amount of funds required from investors to finance MidAmerican's day-to-day operations. The term "lag days" refers to the time period between the rendering of the service and the payment by the customer. "Lead days" refers to the time period between the incurrence of the expense and the payment by MidAmerican. The net day lag is the difference between revenue lag days and expense lead days. In its direct filing, MidAmerican developed a CWC amount of $1,488,000 calculated based on the net lag methodology. MidAmerican Sch. B-8, at 1. With this approach, for each expense classification, the net day lag for that expense classification is multiplied by the daily expense for that expense classification to produce the CWC requirement for that expense classification. The individual expense classifications are then summed to yield the total CWC requirement.

In its direct testimony, Staff calculated its CWC requirement of $280,000. Staff's calculation of CWC used zero lag days for the pass-through tax, Illinois Electricity Excise Tax; included an additional pass-through tax, municipal utility taxes, with zero lag days and 45.75 lead days; and included Energy Assistance Charges with zero lag days. Staff Ex. 5.0 at 2-3, ll. 40-46.

In an effort to narrow the contested issues in this case, MidAmerican, in its rebuttal filing, accepted Staff's proposed adjustments to CWC, subject to the use of the correct Energy Assistance Charges, and calculated a CWC requirement of $253,000. MidAmerican Ex. NGC 2.0 at 3, ll. 36-39. Additionally, MidAmerican agrees with Staff witness Jones' testimony that the under-over collection of Fuel Adjustment Clause ("FAC") does not affect cash working capital and therefore should not be included in rate base. MidAmerican Ex. MJA 3.0 at 3, ll. 30-34.

In its rebuttal filing, Staff incorporated the modifications suggested by MidAmerican and calculated a CWC requirement of $200,000, assuming all other Staff changes are accepted. The calculation of the CWC is not contested and the Commission's final determination of

MidAmerican's total rate base, return on equity and operating costs, along with agreed upon adjustments to reconcile income tax expenses will determine how CWC will be calculated for final rates. MidAmerican Ex. NGC 3.0 at 3, ll. 42-47, MidAmerican Ex. NGC 3.1, Sch. A Surrebuttal and Staff Ex. 14.0, Sch. 14.01.

3. Accumulated Deferred Income Tax Related to FAC

MidAmerican accepted Staff's adjustment related to the Accumulated Deferred Income Tax ("ADIT") related to the over-collection of the FAC. MidAmerican Ex. MJA 3.0 at 3, ll. 28-30; *see* Staff Ex. 10.00, Sch. 10.08.

4. Materials and Supplies

MidAmerican also agreed to accept Staff's material and supplies A/P adjustment. MidAmerican Ex. MJA 2.0 at 3, ll. 38-39; *see* Staff Ex. 1.00, Sch. 1.04, column (d).

5. Fossil Fuel Inventory

MidAmerican accepted certain aspects of Staff's adjustment related to fossil fuel inventory. MidAmerican proposed an alternative calculation to reflect the significant increase to coal transportation costs beginning in 2013. MidAmerican Ex. MJA 2.0 at 4, ll. 53-55. Staff accepted MidAmerican's alternative adjustment because it reflects the five-year average quantities while reflecting current prices. Staff Ex. 11.0 at 3, ll. 48-50.

6. Original Cost Determination

Staff requested that the Commission include the following provision in this Order:

> It is further ordered that the $701,292,619 original cost of plant for MidAmerican at December 31, 2012, as reflected on the Company's Schedule B-4, Page 4 of 4, line 81, Column(e) is unconditionally approved as the original cost of plant.

See Staff Ex. 2.0 at 6.

MidAmerican does not object to Staff's recommendation.

Additionally, Staff recommended that the Commission approve MidAmerican's presentation of Illinois generation assets pursuant to the 1997 legislation for regulatory ratemaking purposes, as more fully described in the responses to DR BAP 2.01 and DR BAP 13.04, Attachments B and C, respectively, to Staff Exhibit 2.0; *See also* Staff Ex. 11, at 6, ll. 114-130. MidAmerican agreed with Staff's recommendation. MidAmerican Ex. MJA 3.0, at 4, ll. 48-53.

7. <u>Planned Retirement of Generation Stations</u>

<u>Supply procurement</u>

MidAmerican provided testimony regarding its generation supply and the challenges of harmonizing the different regulatory and legislative frameworks between states. MidAmerican Ex. NGC 1.0 at 10, ll. 188-198. MidAmerican noted that its current allocation methodology may not be viable much longer given the possible retirement of generation currently allocated to Illinois to meet customer demand. *Id.* at ll. 199-220. To address this issue, MidAmerican requested to establish a non-fuel cost per MW in this proceeding that could potentially be used to make future pricing adjustments in specific situations, but the Commission would at a later time determine whether such pricing adjustments should be made. *See generally*, MidAmerican Ex. NGC 1.0 at 10-15, ll. 188-304, and MidAmerican Ex. NGC 2.0 at 4, ll. 55-65. This cost would be determined by dividing the non-fuel generation costs approved for use in MidAmerican's functional cost-of-service study used to set rates in this proceeding by the 539.8 MW assigned to Illinois in the test year. The resulting cost would be $117,412 per MW based on MidAmerican's filed values. MidAmerican Ex. NGC 1.0 at 13, ll. 269-270.

Staff indicated it did not object to this approach in this proceeding as long as it is clear the Commission is not making a determination in this case about the nature of any generation cost allocation and pricing mechanism that may be considered in some future proceeding. Staff Ex. 9.06 at 6, ll. 111-122. As noted above, MidAmerican agreed that its intent was not to limit the Commission's determination. Accordingly, the Commission should approve the calculation of MidAmerican's cost of generation as presented in MidAmerican Ex. 1.1, Sch. A, using final generation rate base, operating costs and return as determined in this proceeding. The Commission's determination of the generation cost calculation in this case does not limit the Commission's determination in any future cases regarding generation cost allocation.

Reporting Requirements For Planned Retirement of Generating Stations

Staff recommended that MidAmerican be required to file a quarterly report, "Plan for Meeting Generation Needs Beyond 2015" on e-docket in this proceeding with a copy to the Manager of Accounting. Staff Ex. 11.0 at 3-4, ll. 55-70.

MidAmerican agreed to file a quarterly report using the same format as the previous Staff Financial Monitoring Project reports at the time the generation is retired. MidAmerican Ex. NGC 3.0 at 3, ll. 26-33. MidAmerican testified this information would provide the Commission with more adequate information to determine if further investigation of the reasonableness of MidAmerican's base rates will be needed. MidAmerican noted that it has already provided an estimate of the impact on base rates of the retirement of the subject generation units in response to Staff Data Request BAP 16.01. *See* Staff MidAmerican Joint Cross Ex. 1.

MidAmerican anticipates keeping Staff apprised of the status of the generation units in question and of its plans for capacity and energy purchases in any event. MidAmerican has no objection to filing quarterly reports with the Commission regarding these issues.

C. Contested Rate Base Adjustments

1. Rate Base Adjustment Related to PIP Incentive Compensation

As further discussed in Section IV, D.1, MidAmerican disagrees with Staff's proposal to disallow incentive compensation. MidAmerican and Staff, however, do agree with the methodology for calculating the rate base adjustment for incentive compensation and related payroll taxes and pension costs, should the Commission deny in whole or in part any of the incentive compensation. MidAmerican Ex. MJA 3.0 at 3, ll. 41-44.

2. Pension Asset

MidAmerican's proposal to include prepaid pension expenses in rate base is reasonable because this amount must be financed by MidAmerican, *i.e.*, with shareholder dollars. Amounts contributed to the pension trust, and earnings on such amounts, must be used solely for plan benefits or plan administration and are not available for MidAmerican's general use.[1] Accordingly, MidAmerican proposes to include $786,790 of prepaid pension expense in its Illinois rate base. Staff Ex. 4.0, Att. A; *see also* MidAmerican MJA 3.1, Sch. B-1 Surrebuttal, line 11. This amount represents the cumulative amount of pension plan contribution in excess of amounts expensed. *Id.*, Att. A at 1. Earnings on contributions to the external pension trust reduce pension expense, and such reduction is embedded in the pension costs included in the revenue requirement. MidAmerican Ex. RRT 23.0 at 5, ll. 87-99; citing *Southern Company Services, Inc.*, Docket Nos. ER08-129-000 and ER08-129-001, Order on Tariff Filing, 122 FERC ¶ 61,218 (March 10, 2008). MidAmerican's proposed accounting adjustment is consistent with

[1] *Re: MidAmerican Energy Company*, ICC Docket No. 09-0312, Order (March 24, 2010).

ratemaking principles and consistent with the ratemaking treatment adopted by the Federal Energy Regulatory Commission ("FERC").

Staff proposes an adjustment to disallow MidAmerican's pension asset and related ADIT from rate base. Staff Ex. 4.0 at 2, ll. 42-46. Staff proposes to remove the prepaid pension asset from rate base, but leave the associated pension income as a reduction to expense. Staff contends this adjustment is necessary because MidAmerican has not demonstrated that the pension asset was created with anything other than ratepayer funds. *Id*. Staff cites to various Commission orders where the Commission has denied the inclusion of pension assets in rate base because the pension assets were not shown to be from a source other than ratepayer supplied funds.[2]

Reliance on past rate case orders may offer the Commission some guidance on this issue, but the Commission decision in this case must be based on the record evidence and not the specific facts and findings in other dockets. 220 ILCS 5-10-103; 220 ICLS 5/10-201(e)(iv)(A).

The evidence in this case demonstrates that the pension expenses must be financed. As MidAmerican explained in testimony, funding in excess of amounts included in rates as expense must be financed, and as such, it is appropriate to earn a return on the pension asset. MidAmerican Ex. RRT 2.0 at 9, ll. 177-178.

Staff on the other hand, contends that the source of funds for the test year pension contributions funding the prepaid pension asset is ratepayer supplied funds. MidAmerican Ex.

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[2] *See also* Staff Ex. 4.0 at 4-6, citing *North Shore Gas Company and The Peoples Gas Light and Coke Company*, ICC Docket Nos. 09-0166/09-0167 (Cons.), at 36 (January 21, 2010); *Peoples v. Illinois Commerce Commission*, Nos. 1-10-0654, 1-10-0655, 1-10-0936, 1-10-179, and 1-10-1846 and 1-10-1852, Consolidated, Appellate Court (First District-Fifth Division) September 30, 2011, at 42-43, par. 69-71; *North Shore Gas Company and The Peoples Gas Light and Coke Company*, ICC Docket Nos. 11-125 0280/11-0281 (Cons.), at 33 (January 10, 2012); *North Shore Gas Company and The Peoples Gas Light and Coke Company*, ICC Docket Nos. 12-0511/12-0512 (Cons.), at 90 (June 18, 2013).

RRT 2.0 at 8, ll. 147-149. As Staff indicated in a data request response, "ratepayer supplied funds are funds provided through normal operating revenues of a utility." MidAmerican Ex. RRT 2.5. Using Staff's logic, a utility is not allowed to use any retained earnings to make investments. Consequently, MidAmerican could not be able to include a substantial amount of investment in rate base because MidAmerican has invested significant amounts in utility plant using retained earnings, or what Staff labels as "ratepayer-supplied funds." *See* MidAmerican Ex. RRT 2.5 and MidAmerican Ex. RRT 2.0 at 9, ll. 161-169. Staff properly has recommended these investments be included in rate base, but has inexplicitly carved out an exception for the pension asset. Staff's argument is not only circular, but fails as a matter of law.

Staff's argument ignores the general rule established by the United States Supreme Court that ratepayers do not acquire a legal or equitable interest in utility property, *i.e* the revenue generated by service belongs to the utility. The United State Supreme Court has found that:

> ***The revenue paid by the customers for service belongs to the company.*** The amount, if any, remaining after paying taxes and operating expenses, including the expense of depreciation, is the company's compensation for the use of its property. If there is no return, or if the amount is less than a reasonable return, the company must bear the loss.
>
> *Board of Pub. Util. Comm'rs. v. New York Tel. Co.,* 271 U.S. 23, 31-32 (1926) (emphasis added.)

The United States Supreme Court's reasoning is sound and consistent with regulatory principles. A utility makes investments and incurs expenses to provide service. In exchange for the service, the customers reimburse the utility for its expenses and compensate the stockholders for investments. Therefore, as a matter of law, the revenue generated from ratepayer supplied funds becomes stockholder funds and Staff's argument is inconsistent with the law.

In this docket, MidAmerican has shown its accounting treatment of its pension asset is consistent with the law, and ratemaking principles. MidAmerican's cost of service includes return on the prepaid pension expense, but MidAmerican's cost of service is reduced by the associated pension income, *i.e.* the earnings from pension trust embedded in the net periodic benefit cost that is recorded to the income statement.

As MidAmerican pointed out in testimony, FERC's conclusion and the basis for its conclusion in Docket No. ER08-129-000, best describes the accounting treatment MidAmerican has used in this case. In that docket, FERC noted the following:

> ….unlike prepaid insurance or prepaid rent, prepaid pensions arise when the income earned on pension funds accumulated in an external trust exceeds the net periodic pension cost, *i.e.*, the current year's pension income exceeds the current year's pension expense. By law, a utility cannot withdraw such income, although it is required (under Generally Accepted Accounting Principles) to reflect the income as a reduction to its pension expense, *i.e.*, as a credit to Account No. 926. At the same time, the utility records a corresponding amount of prepaid pensions. If that reduction in pension expense is used in determining a utility's rates, there will be a corresponding reduction in the amounts collected from ratepayers. Because a utility cannot withdraw the pension income, it will be out-of-pocket for the amount of pension income that has reduced rates, *i.e.*, it must reduce its pension expense by the amount of income, even though it is not allowed to receive such income from the pension trust. Thus, when a utility's rates have been reduced by pension income, but the utility has not received such income from the external trust, <u>it will have to finance such amount</u>, and is entitled to include the pension income in rate base.
>
> Docket No. ER08-129-000, 122 FERC ¶ 61,218, at ¶21, (emphasis added)

Staff's proposed disallowance is inconsistent with FERC's accounting treatment because Staff fails to recognize that MidAmerican must finance the pension asset, clearly as a matter of law and by matter of normal business operations. MidAmerican's financing responsibility is not based on ratepayer funding. Furthermore, MidAmerican's financing of its prepaid pension is separate and distinct from the pension income used to reduce MidAmerican's pension expense.

MidAmerican acknowledges that FERC does not have jurisdiction over the rates to be established in this rate case. However, FERC's explanation of proper accounting treatment related to pension assets should not be ignored out of hand as Staff suggests. Staff Ex. 13.0 at 5, ll. 96-112. The Commission's Uniform System of Accounts for Electric Utilities, 83 Ill. Admin Code Part 415, incorporates FERC's system of accounts by reference subject to certain exceptions.

Staff also urges the Commission to disregard this FERC order because it relates to a formula rate proceeding. *Id.*, ll. 103-112. Staff makes a distinction where there is no difference in ratemaking treatment. Regardless of whether the revenue requirement for a utility is approved through an annual formula rate mechanism or approved through a historical test year, costs and benefits still must be balanced or "matched."

The Illinois legislature charged the Commission with setting rates which are "just and reasonable" not only to ratepayers but to the utility and its stockholders. *Business and Professional People for the Pub. Interest v. Illinois Commerce Comm'n*, 146 Ill. 2d 175, 208-209 (1991), citing 220 ILCS 5/1-102 and 5/9-201; *see also* 220 ILCS 5/1-102(d). It is not reasonable to allow an accounting adjustment that offsets costs to ratepayers but does not recognize the corresponding cost to the utility and its shareholders of obtaining that cost offset. Consequently, the Commission should approve MidAmerican's $786,790 of prepaid pension expense in its Illinois rate base since the pension income is used to off-set MidAmerican's pension expense. *See generally* Schedules B-1 and B-16 Surrebuttal.

As an alternative resolution to this issue and consistent with ratemaking principles and established FERC accounting treatment, MidAmerican does not object to the Commission removing the pension asset from rate base and making a corresponding adjustment to remove pension income currently proposed to off-set the cost of service. MidAmerican Ex. RRT 2.0 at 10-11, ll. 191-209. MidAmerican's alternative proposal is just and reasonable to both ratepayers and shareholders.

D. MidAmerican's Proposed Rate Base

Description	MEC Pro Forma Rate Base	Accepted Staff Adjustments	Additional MEC Pro Forma Adjustments	MEC Adjusted Rate Base
(a)	(b)	(c)	(d)	(e)
Gross Utility Plant in Service	$774,313	$ -	$ -	$774,313
Less: Accumulated Depreciation	(381,765)	-	-	(381,765)
Net Utility Plant in Service	392,548	-	-	392,548
Additions to Rate Base				
Cash Working Capital	257	-	(4)	253
Materials and Supplies	4,600	-	-	4,600
Allowances	284	-	-	284
Fuel Stock	10,121	-	-	10,121
Nuclear	5,467	-	-	5,467
Accumulated Provision for Pensions	787	-	-	787
Budget Plan Balances	926	-	-	926
Deductions from Rate Base				
Customer Advances for Construction	(740)	-	-	(740)
Customer Deposits	(151)	-	-	(151)
ITC3%	(6)	-	-	(6)
Accumulated Deferred Income Taxes	(78,770)	(232)	-	(79,002)
Self Insurance Reserve Quad Cities	(251)	-	-	(251)
Rate Base	$335,072	$ (232)	$ (4)	$ 334,836

IV. Revenue Requirement – Operating Revenues and Expenses

A. Overview

MidAmerican Ex. 3.1, Sch. A-2 Surrebuttal summarizes the Illinois jurisdictional electric revenue requirement, and the schedule reflects a revenue deficiency of $20,939,000. *See* MidAmerican Ex. RRT 3.1, Sch. A-2 Surrebuttal, line 12, column (b). Accordingly, MidAmerican proposes a rate increase of $20,939,000 in order to recover the test year revenue deficiency. *See* MidAmerican Ex. RRT 3.1, Sch. C-1 Surrebuttal, line 15, column (g).

While MidAmerican does not necessarily agree with the rationale for Staff's adjustments and reserves the right to rebut similar positions in future cases, in the interest of narrowing the issues in this case, MidAmerican agreed to accept a number of Staff's adjustments to the test year pro forma operating income. MidAmerican accepted Staff's adjustments to steam production maintenance, distribution maintenance, industry association dues, demonstration and selling expense, miscellaneous general expense, payroll taxes associated with the long-term incentive partnership plan, and retirement plan cost adjustments.[3] Staff Ex. 1.0, Sch. 1.02 columns (c), (d), (e), (f), (g), (h), and (m), respectively.

B. MidAmerican's Proposal

In its direct testimony, MidAmerican indicated that for the 2012 historical test year, its Illinois jurisdictional electric tariffed revenues were $132,522,000. Originally, MidAmerican proposed to increase rates and revenues by $21,593,000; after accepting certain adjustments to its proposal recommended by Staff and in part, the DOD, MidAmerican is now proposing a rate

[3] As noted in MidAmerican Ex. RRT 2.0, if the Commission does not allow MidAmerican to include its investment in pension funding in rate base, then the assumed return on the pension asset must also be removed from pension expense. MidAmerican Ex. RRT 2.0 at 10-11, ll. 198-209.

increase of $20,939,000. As outlined below, MidAmerican's proposed revenue requirement is based on actual costs, and as such is reasonable, and should be adopted by the Commission.

C. Uncontested adjustments to MidAmerican's proposal

Staff proposed numerous adjustments to the Company's operating income statement, which MidAmerican did not contest for purposes of narrowing the issues in this proceeding. Neither Deere nor DOD took a position with respect to the adjustments. As demonstrated below, the uncontested portion of MidAmerican's revenue requirement is reasonable and should be adopted by the Commission.

1. Retirement Plan

MidAmerican accepted the retirement plan cost adjustments proposed by Staff. MidAmerican Ex. RRT 2.0 at 4, l. 46; Staff Ex. 4.0 at 11, ll.262-271. Staff adjustments reflect a reduction from operating expenses to reduce the 2012 test year amounts for retirement plan costs to a three-year average balance for the retirement plan costs. The adjustment uses the same methodology as the Company's adjustment to retirement plan costs in Schedule C-2.3, except it is based upon the most recent actuarial reports available. It also corrects an allocation error disclosed in MidAmerican's supplemental response to Staff DR DLH 2.10. *Id*.

2. Industry Dues

MidAmerican originally proposed to include certain industry dues in its operating statement. MidAmerican Sch. C-1. Staff recommended that these costs be excluded. MidAmerican accepted Staff's adjustment to exclude industry association dues, which removes expenses associated with certain industry association dues. Staff Ex. 3.0 at 5-6, ll. 102-161; MidAmerican Ex. RRT 2.0 at 3, ll. 43-45; MidAmerican Ex. RRT 2.1, Sch. C-1 Rebuttal.

3. Demonstration & Selling

MidAmerican originally proposed to include certain demonstration and selling expenses in its operating statement. MidAmerican Sch. C-1. Staff recommended that these costs be excluded. MidAmerican accepted Staff's adjustment to remove certain demonstration and selling expenses that Staff noted are promotional in nature or for goodwill purposes. Staff Ex. 3.0, at 8-11, ll. 182-238; MidAmerican Ex. RRT 2.0, at 3, ll. 44-47; MidAmerican Ex. RRT 2.1, Sch. C-1 Rebuttal.

4. Miscellaneous & General

MidAmerican accepted Staff's adjustment to the operating statement to remove certain miscellaneous general expenses. Staff Ex. 3.0, at 11-14, ll. 239-297; MidAmerican Ex. RRT 2.0, at 3, ll. 43-47; MidAmerican Ex. RRT 2.1, Sch. C-1 Rebuttal.

5. Payroll Taxes Associated with LTIP

As discussed below in subsection 8.f., MidAmerican removed the amount of executive incentive compensation included in the 2012 test year operating expenses. MidAmerican Ex. RRT 1.0, at 11, ll. 206-212, and MidAmerican Sch. C-2.12; *see also* MidAmerican Ex. MAG 1.0, ll. 188-201.

Staff recommended a further adjustment to the operating statement to remove payroll taxes associated with the LTIP incentive compensation expense that MidAmerican removed from its revenue requirement. Staff Ex. 3.0 at 14, ll. 302-308. MidAmerican accepted this adjustment. MidAmerican RRT 2.0 at 3, l. 45 and MidAmerican Sch. C-2.12 Rebuttal.

6. Income Tax Adjustment

MidAmerican accepted Staff's adjustment to include the adjustments recorded in 2013 to reconcile income tax expense booked in 2012 with the amounts on the 2012 federal and state tax returns. Staff Ex. 1.0 at 8-9, ll. 183-189; MidAmerican Ex. RRT 2.0 at 3, ll. 30-37; MidAmerican Ex. RRT 3.0 at 8, ll. 158-169; MidAmerican Ex. RRT 3.3.

7. Interest Synchronization

Both MidAmerican and Staff updated their respective interest synchronization calculations to reflect the changes to rate base for the uncontested issues. The parties agree with how interest synchronization is calculated. MidAmerican Ex. RRT 2.0 at 6-7, ll. 113-117.

8. Pro Forma Adjustments

a. Out of Period Income Tax Adjustment

MidAmerican presented an adjustment to increase income tax expense through the reversal of entries made during 2012 that modified income tax expense for periods prior to 2012. MidAmerican Ex. RRT 1.0 at 8, ll. 152-155. Since the increases to income tax expenses are not representative of ongoing expense relative to test year activity, it is reasonable to make this pro forma adjustment. The tax adjustments recorded in 2012 reconciled income tax expense booked during 2012 to the amounts reflected in the 2011 tax return that was filed in September 2012, and included new estimates for bonus depreciation relative to those that were originally contemplated at the time the books were closed for 2011. *Id.* at 8-9, ll.155-160. Since these adjustments pertain to 2011, and not 2012, they are not appropriate to include in the test year for this case. MidAmerican Ex. RRT 1.0 at 8-9, ll. 152-160 and MidAmerican Sch. C-2.6; MidAmerican Ex. RRT 2.0 at 3, ll. 30-36.

b. Depreciation on Rate Base

MidAmerican proposed an adjustment to increase depreciation expense for the depreciation associated with the rate base adjustments net of lower depreciation expense associated with a 2013 depreciation study. MidAmerican Ex. RRT 1.0 at 9, ll. 163-166;

MidAmerican Sch. C-2.7. Staff did not contest the Company's adjustment. MidAmerican Ex. RRT 2.0 at 3, ll. 30-36.

c. Weather Normalization

MidAmerican presented a weather normalization adjustment to decrease test year operating revenue to account for the impact of unseasonable weather during the test year. MidAmerican Ex. RRT 1.0 at 9, ll. 176-178, and MidAmerican Sch. C-2.9; *see also* Section VII.B.3. below for further discussion on the weather normalization adjustment.

d. Coal Transportation Costs

MidAmerican proposed an adjustment to reflect increases in cost of fuel for the effect of new, long-term coal transportation contracts MidAmerican entered into during 2012 with BNSF Railway and Union Pacific Railroad. These contracts took effect January 1, 2013, and replaced an expired contract with Union Pacific that had been in place for more than a decade. Prices under both new contracts are significantly higher than those under the expired Union Pacific contract. The adjustment is based on 2012 coal tonnages burned at MidAmerican-operated plants to which coal is delivered pursuant to these agreements. MidAmerican Ex. RRT 1.0 at 10, ll. 181-188; MidAmerican Sch. C-2.10; MidAmerican Ex. RRT 2.0 at 3, ll. 30-36.

e. Bad Debt Expense

MidAmerican made a pro forma adjustment to reduce bad debt expense for the application of a lower estimated accrual percentage. During 2012, MidAmerican accrued bad debt expense at approximately 0.49% of tariffed revenue. Based on favorable recent actual bad debt experience, MidAmerican believes a lower rate is appropriate. The adjustment reflects the difference between test year expense at a rate of 0.49% and that using a rate of 0.3% of 2012 tariffed revenue. MidAmerican Ex. RRT 1.0 at 10-11, ll. 198-203; MidAmerican Ex. RRT 2.0 at 3, ll. 30-36; and MidAmerican Ex. Sch. C-2.11.

f. Long-Term Incentive Partnership ("LTIP") Plan

MidAmerican removed the amount of executive incentive compensation included in the 2012 test year operating expenses. This adjustment decreases test year operating expenses for costs accrued for the LTIP plan. The LTIP plan, administered by Berkshire Hathaway Energy Company f/k/a MidAmerican Energy Holdings Company, provides incentive payments to selected participants based in large part on predominantly financial performance factors. MidAmerican is not seeking recovery for these costs at this time. MidAmerican Ex. RRT 1.0 at 11, ll. 206-212; MidAmerican Sch. C-2.12; *see also* MidAmerican Ex. MAG 1.0, ll. 188-201, and Subsection 5 above.

g. Customer Contract Revenue

MidAmerican proposed an adjustment that increases test year revenue to reflect the expiration of a customer contract and resultant return of the customer to tariffed rates. MidAmerican Ex. RRT 1.0 at 11, ll. 215-217, and MidAmerican Ex. Sch. C-2.13; MidAmerican Ex. RRT 2.0 at 3, ll. 30-36.

h. Transmission Delineation - 69 kV - Transmission Transfer

MidAmerican proposed an adjustment to decrease test year other operation and maintenance expense, increase test year depreciation expense and change the characterization of such costs from distribution to transmission to reflect the annualization of such changes that occurred September 1, 2012 in conjunction with the redelineation of MidAmerican's 69 kV system. The reclassification of these assets was performed pursuant to orders in FERC Docket No. EL12-57-000, ICC Docket No. 11-0492 and Iowa Docket No. SPU-2011-0005.

Jurisdictional cost shifts occurred because distribution costs are generally specifically assigned to the jurisdiction in which the assets are physically located, and transmission costs are generally allocated among all jurisdictions. MidAmerican Ex. RRT 1.0 at 11-12, ll. 220-229; MidAmerican Ex. Sch. C-2.14; MidAmerican Ex. RRT 2.0 at 3, ll. 30-36.

i. Environmental Chemical Costs

MidAmerican proposed an adjustment to increase test year operations expense for the estimated cost of chemicals to be consumed in the operation of environmental equipment being installed at Neal Unit 3, Neal Unit 4 and Ottumwa Generating Station. The chemicals include lime, urea and activated carbon. The adjustment applies the actual 2012 cost per megawatt hour generated for such chemicals at Walter Scott Unit 4 to the 2012 megawatt hours generated at Neal 3 and 4 and Ottumwa. MidAmerican Ex. RRT 1.0 at 13, ll. 250-257, and MidAmerican Ex. Sch. C-2.18; *see also* MidAmerican Ex. STM 1.0.

9. Rate Case Expenses

The evidentiary record contains evidence demonstrating that MidAmerican's proposed rate cases expenses are just and reasonable. Moreover, the record evidence is more than sufficient for the Commission to specifically assess the justness and reasonableness of those expenses as required by Section 9-229 of the Act. 220 ILCS 5/9-229. Staff supports the recovery of MidAmerican legal and travel expenses after examining the evidence presented by MidAmerican. In regards to the recovery of rate case expenses for legal and travel expenses, Staff found those costs to be just and reasonable based on the evidence.

Based on the evidentiary record, the Commission should find that MidAmerican's uncontested legal and travel expenses of $111,000 should be included in the revenue requirement and amortized over five years because they are just and reasonable. As outlined below in

Subsection D.5, MidAmerican's outside witness expense is also just and reasonable and the Commission should approve MidAmerican's total rate case expenses of $181,000.

a. Legal Expenses

MidAmerican presented evidence noting that MidAmerican primarily relied upon in-house attorneys for the preparation and prosecution of the case and that outside counsel is used only for consultation on specific and limited issues, thus limiting the incremental legal fees that are included in rate case expenses. MidAmerican Ex. DLK 2.0 at 5, ll. 95-98. MidAmerican presented evidence regarding outside counsel's expertise in rate case litigation, hourly rate and number of hours of work performed. Staff Ex. 5.0, Confidential Attachment A, *see also* MidAmerican Ex. DLK 3.1, Sch. A Surrebuttal.

Staff accepted the MidAmerican's projected rate case costs for outside counsel costs of $90,000. Staff Ex. 14.0 at 4, ll. 78-81. Staff noted that MidAmerican submitted documentation to support rate case costs through responses to Staff's data requests. The documentation included invoices for outside counsel. Staff Ex. 14.0 at 5, ll. 84-86.

b. Travel Expenses

Staff accepted the MidAmerican's projected rate case costs of $21,000 for travel, meals, lodging and supplies. Staff Ex. 14.0 at 4, ll. 78-81. Staff noted that MidAmerican submitted documentation to support rate case costs through responses to Staff's data requests. The documentation included invoices and support for travel, meals, lodging and supplies. Staff Ex. 14.0 at 5, ll. 84-86. These incremental costs are reasonably incurred since they related to supplies for the filing, and travel, meals and lodging for the hearing.

D. Contested adjustments to MidAmerican's proposal

1. PIP Incentive Compensation and Associated Payroll Tax and Pension Costs

In order to ensure its employees are paid on comparable terms to others performing equivalent work, MidAmerican compensation for non-represented employees consists of both base and incentive pay. MidAmerican Exs. MAG 1.0 at 3-5, ll. 32-72; MAG 1.1, Sch. A. MidAmerican maintains two incentive compensation programs. The Performance Incentive Program ("PIP") applies to all non-represented employees and requires the accomplishment of various corporate and individual goals set each year to receive an award. MidAmerican Exs. MAG 1.0 at 3-4, ll. 49-57; MAG 2.0 at 3-4, ll. 49-61. MidAmerican proposes to recover costs associated with the PIP as part of the proposed revenue requirement. MidAmerican also maintains the LTIP for senior executives and key employees that, unlike the PIP, is triggered by achievement of after-tax net income and other corporate goals. MidAmerican Exs. MAG 1.0 at 10, ll. 188-201; MAG 2.0 at 3, ll. 39-48. As shown on MidAmerican Sch. C-3.12, MidAmerican has removed all expense associated with the LTIP from the proposed revenue requirement.

Staff witness Bridal proposes a series of adjustments to remove 100% of the effects of MidAmerican's PIP. These adjustments are to remove $971,026 of PIP compensation charged to expense from the revenue requirement and an additional $175,977 of capitalized PIP incentive compensation offset by associated accumulated depreciation and ADIT. Staff Ex. 12.0, Sch. 12.01. Additionally, amounts of associated payroll taxes and pension costs associated with PIP compensation are removed. Staff Ex. 12.0, Schs. 12.02 and 12.03.

Witness Bridal testified that even though most of the 39 PIP goals are appropriate for incentive compensation plans, he recommended 100% disallowance of incentive compensation earned under the PIP. He proposed disallowance because he could not determine the impact of non-allowable goals on PIP incentive compensation. Tr. at 70, l. 3 through Tr. at 71, l. 2; Tr. at 71, l. 18 through Tr. at 72, l. 10. He contends that PIP compensation is (1) subjective or discretionary in nature; (2) based in part on the financial performance of the Company; (3) based on goals that have no direct payout percentages assigned and (4) based on various goals which are not associated with Illinois electric jurisdictional public utility service. Staff Ex. 12.0, ll. 53-60. Aside from substantive objections to two goals that are based on the perceived importance of financial performance in the overall PIP plan, and six goals that are deemed unrelated to Illinois electric regulation, Staff's objections are largely to the mechanics of the program. Staff did not consider whether any of the results from the PIP provided tangible ratepayer benefits or even whether the overall level of market-based pay expense was reasonable. Staff Ex. 12.0, ll. 133-138.

MidAmerican has provided unrebutted evidence demonstrating tangible ratepayer benefits such as high levels of customer satisfaction, declining safety incidents and cost control. MidAmerican Ex. MAG 2.1, Schs. A-C. MidAmerican also provided evidence that its overall levels of employee compensation are reasonable. MidAmerican Ex. MAG 1.0 at 4-5, ll. 58-72; Ex. MAG 1.1, Sch. A. Staff's adjustments to remove incentive compensation expense associated with MidAmerican's PIP should be denied. The Commission approved incentive compensation expense associated with the PIP in MidAmerican's natural gas revenue requirement in Docket No. 09-0312 as supported by the testimony of MidAmerican witness Grannes, the compensation professional who testifies in this case. MidAmerican Ex. MAG 2.0 at 7, ll. 128-133; Staff Ex. 12.0, ll. 195-198. MidAmerican should also be authorized to include all PIP expense in the revenue requirement adopted in this electric rate proceeding.

a. Overview of MidAmerican's Performance Incentive Plan

MidAmerican's proposed revenue requirement in this case includes market-based employee compensation consisting of base pay and incentive compensation. MidAmerican Ex. MAG 1.0 at 3-4, ll. 40-57. In order to attract and maintain competent employees, MidAmerican takes great care to keep its employee salaries at market levels with a target of market median pay. *Id.* To ensure that pay is maintained at market levels and that unreasonably low or excessive salaries are avoided, MidAmerican reviews base pay and incentive targets of comparable employers using surveys. MidAmerican Ex. MAG 1.0 at 3-4, ll. 42-48, and at 4-5, ll. 58-72; Ex. MAG 2.0 at 3-4, ll. 49-61. One critical element needed to attract and retain employees and encourage superior performance is to place part of each employee's market-level pay at risk under MidAmerican's PIP. MidAmerican Ex. MAG 1.0 at 6, ll. 94-101. Just as the total compensation level is based on analysis of labor market data, the base and "at risk" proportions of pay are also set to reflect labor market expectations.[4] Typically 6-20% of an employee's total compensation is placed at risk. *Id.*, ll. 64-68. With acceptable performance of individual goals, employee compensation will be at market levels. Exceptional performance warrants higher-than-target compensation and lesser performance lower-than-target compensation. *Id.*, ll. 49-57, 73-93. Even though some employees receive more and some employees receive less, the company manages PIP awards to the determined PIP payout for the year. *See* Staff Ex. 12.0, Att. B, at 2. To the extent rate recovery is at less-than-100% incentive pay, MidAmerican total recoverable labor expense is reduced below fair market levels.

MidAmerican has maintained this system since 1997. MidAmerican Ex. MAG 1.0 at 8, ll. 151-153. Company witness Grannes, a compensation professional with almost 15 years of

[4] *See* MidAmerican Ex. MAG 1.1, Sch. A, which is a survey of various utilities showing incentive pay targets. It should be noted that all of the surveyed utilities utilize incentive pay.

professional experience, testified that the Company experiences higher levels of employee performance when a portion of pay is at risk under an incentive plan like the PIP. MidAmerican Ex. MAG 1.0 at 2, ll. 5-15, and at 6, ll. 94-101.

The purpose of MidAmerican's incentive pay system is to maximize overall performance of the utility. *Id.*, ll. 94-101. Each year, MidAmerican's President sets goals based on six consistent company core principles:

- customer service
- employee commitment
- financial strength
- environmental respect
- regulatory integrity and
- operational excellence

MidAmerican Ex. MAG 1.1, Sch. B; MidAmerican Ex. MAG 2.0 at 4, ll. 62-66. The core principles are the metrics that are the foundation of all MidAmerican actions, including establishment of the annual goals of every employee from the President to the customer service representative and the operations supervisors. *See* e.g., MidAmerican Ex. MAG 3.1, Sch. A (President's goals arranged around core principles); Staff Ex. 3.0, Att. 1 at 2 (individual goals support organizational goals based on core principles); MidAmerican Ex. MAG 1.1, Sch. B (communication to employees of core principles); MidAmerican Ex. MAG 2.1, Sch. D (employee performance evaluations based on achievement of goals based on core principles); MidAmerican Ex. MAG 2.1, Sch. E at 5 (communication regarding performance evaluations addressing each employee's safety goal, part of employee commitment).

The MidAmerican goals are created each year to support each of the core principles. MidAmerican Ex. MAG 3.1, Sch. A. In turn, the core principles and the associated company goals become the focus for employee goals. Each employee works with his or her manager to set individual goals based on applicable core principles and associated corporate-wide goals. MidAmerican Ex. MAG 2.0 at 4, ll. 62-71. Performance to individual goals is evaluated by an employee's immediate supervisor. *Id.*, ll. 77-80. Two examples of the evaluation of employee performance to individual goals are included as MidAmerican Ex. MAG 2.1, Sch. D, along with the scoring matrix for performance evaluation in the call center. These examples clearly show that employee performance is measured against the same core principles. One customer service employee has individual goals based on the three core principles of: (i) customer service (satisfaction); (ii) operational excellence: and (iii) employee commitment, which includes safety. An operations supervisor is evaluated on performance to each of the six core principles.

A targeted amount of incentive pay is budgeted each year. MidAmerican Ex. MAG 2.0 at 3, ll. 49-53; Staff Ex. 12.0, Att. B at 2. At the end of the year MidAmerican's President reviews performance of the Company goals supporting each core principle and establishes the total incentive award to be paid to employees under the PIP. MidAmerican Ex. MAG 2.0 at 4, ll. 72-76, Staff Ex. 12.0, Att. B at 2. His detailed report for 2012 outlining MidAmerican performance to each goal is included at Staff Ex 12.0, Att. A at 2. In 2012, PIP payout was 100% of the budgeted incentive target pay. Staff Ex. 12.0, Att. B at 2. Each manager is allocated a portion of this incentive pay and bases his or her employees' incentive pay awards on each individual's performance to goals as shown on MidAmerican Ex. MAG 2.1, Sch. D. MidAmerican Ex. MAG 2.0 at 4, ll. 77-82.

While Staff characterizes MidAmerican's incentive awards as subjective and discretionary, the opposite is true. Incentive pay is highly aligned around the six core principles – starting with corporate goal formation and ending with individual incentive awards. Since all activities at MidAmerican tie in one way or another to the core principles, it is appropriate for them to be the basis of individual goals and awards of incentive pay.

b. MidAmerican's incentive program has resulted in tangible ratepayer benefits and reasonable levels of compensation expense

The Commission specifically authorizes recovering incentive compensation in rates when ratepayer benefits accrue from a program. In *Northern Illinois Gas Company d/b/a Nicor Gas Company,* ICC Docket No. 04-0779, Final Order at 44 (September 20, 2005), the Commission adopted a test for incentive compensation programs, holding:

> Costs related to incentive compensation are recoverable in rates only if the utility demonstrates tangible benefits to ratepayers. *See,* e.g., 03-0403 at 15 ("[T]o recover incentive compensation, the plan must confer upon ratepayers specific dollar savings or other tangible benefits. Furthermore, the degree of benefit that accrues directly to ratepayers, rather than to other stakeholders, is a significant factor in determining whether incentive compensation should be recovered in rates.)

In *Commonwealth Edison Company,* ICC Docket No. 07-0566, Final Order at 61 (September 10, 2008), the Commission articulated what is meant by ratepayer benefits:

> The utility can recover its expenses when it can prove that the expenses are reasonable, related to utility services and of benefit to ratepayers or utility services.

In developing his adjustment to remove all incentive compensation amounts, Mr. Bridal did not challenge whether MidAmerican's incentive compensation expense meets the "ratepayer benefit" standard. Staff Ex. 3.0, ll. 434-442; Staff Ex. 12.0, ll. 104-107. Instead, with the exception of reviewing the goals to determine whether any of them are based on net income or earnings, he focused almost exclusively on the manner in which the program and its goals are administered for purposes of providing the incentive pay. Staff. Ex. 12.0, ll. 144-171.

There is clear and uncontested evidence in the record of ratepayer benefits stemming from the MidAmerican PIP program. These benefits include high levels of customer satisfaction as well as cost containment and safety. *See, e.g.,* MidAmerican Ex. MAG 2.1, Schs. A-C. MidAmerican recognizes that the Commission considers that cost management/cost control efforts to benefit shareholders as well as ratepayers.[5] Unlike cost control/management goals, goals relating to customer satisfaction, cost control, and safety clearly accrue primarily to customers and not shareholders.

The following uncontested customer benefits have arisen as a result of MidAmerican's implementation of incentive compensation since the program's initial implementation in 1997. MidAmerican Ex. MAG 1.0 at 8, ll. 151-153:

- **Long term rate stability.** MidAmerican has not raised its Illinois electric rates since 1992. MidAmerican Ex. DAC 1.0 at 4, ll. 64-65. MidAmerican's total retail electric rates are 13th lowest nationally. *Id.*, ll. 70-71. These rate levels have been achieved despite high levels of investment in generation, transmission and distribution plant and increasing levels of associated operation and maintenance (O&M) expense. *Id.*, ll. 105-112.
- This long term rate stability has led to high and increasing levels of **customer satisfaction**. For six years, MidAmerican has ranked highest in the Midwest Region-Large Segment for overall residential electric customer satisfaction under the J.D. Power

[5] *See Central Illinois Light Company d/b/a Ameren/CILCO*, ICC Docket No. 09-0306, Final Order, Part 1, at 85 (April 29, 2010), where the Commission advised that cost management/cost control measures benefit shareholders as well as ratepayers and should not be allocated to ratepayers exclusively for cost recovery purposes.

and Associates surveys. *Id.,* ll. 81-89. Under another electric customer satisfaction program for our largest industrial customers, conducted by TQS Research, Inc. MidAmerican has one of the highest scores among utilities, with 95.4% of its customers being very satisfied with MidAmerican. *Id.,* ll. 90-99. This 2013 ranking reflects an increase over MidAmerican's 2012 ranking of 94% of customers who were very satisfied with their electric service from MidAmerican. MidAmerican Ex. DAC 1.0 at 6, ll. 90-99; MidAmerican Ex. MAG 2.1, Sch. A.

- **Declining operations and maintenance expense**. Illinois Electric Operations O&M expense has steadily declined since 2001. MidAmerican Ex. MAG 2.1, Sch. B.
- **Safety incident rates have also declined** during the same period. MidAmerican Ex. MAG 2.1, Sch. C.

These accomplishments have occurred during a time when MidAmerican's overall compensation, including both base and incentive pay, has been reasonable, including an average of 96% PIP payouts from 2003-2013. MidAmerican Ex. MAG 3.0 at 6, ll. 128-130. It is uncontested in this case that MidAmerican salaries are at market pay levels. In other words, to achieve these results, MidAmerican has paid no more than what it would have to pay its employees without placing any compensation at risk.

The record demonstrates that implementation of MidAmerican's PIP has resulted in significant customer benefits while maintaining salaries at market levels. Staff's adjustments to remove amounts associated with PIP compensation should be rejected. Staff does not deny, nor offer any evidence to the contrary, that performance results outlined in this case show clear customer benefits arising from PIP implementation. Nor did Staff reject, or offer any evidence to the contrary, that MidAmerican is paying a market level overall compensation that would be reasonably included in rates if characterized as base pay only. So while offering no evidence to challenge customer benefits in the record, the Staff's objection simply goes to PIP administration and a misunderstanding about its goals and objectives.

c. *Staff objections to PIP are unsupported and should be rejected*

Staff has proposed to disallow 100% of the incentive compensation expense, contending that PIP compensation is (1) subjective or discretionary in nature; (2) based in part on the financial performance of the Company; (3) based on goals that have no direct payout percentages assigned and (4) based on various goals which are not associated with Illinois electric jurisdictional public utility service. Staff Ex. 12.0, ll. 53-60.

At the hearing, Staff witness Bridal addressed MidAmerican's program and clarified his position on the PIP. Tr. at 70, l. 3 through Tr. at 72, l. 10. He clarified that he has objected to certain goals that are not related to customer benefits or are of the type the Commission has not generally allowed. In response to a question regarding the parts of MidAmerican's program that he encountered that did result in customer benefits, he identified two financial goals of the income or profit margin nature and six goals he considers to be unrelated to Illinois electric utility service. Tr. at 70, ll. 3-20. Presumably, he found all of the remaining 31 PIP goals to result in tangible customer benefits. Further, he stated that he found no reason to object to any other goals. Tr. at 71, ll. 1-2. While acknowledging that he has no reason to object to the allowable goals, he had to recommend 100% disallowance of all incentive compensation solely because he could not determine the impact of the non-allowable goals. Tr. at 72, ll. 4-10. It is important to clarify what has and has not been challenged.

- Staff did not challenge the total level of MidAmerican compensation.

- Staff did not challenge that MidAmerican pays market-level compensation consisting of base and incentive pay.
- Staff did not challenge that incentive pay results in customer benefits.
- Staff did not challenge that most of MidAmerican's goals result in customer benefits.
- Staff did not challenge MidAmerican's accomplishments or that PIP helped achieve these accomplishments.
- Staff challenges inclusion of only two goals out of six based around the core principle of financial strength. Staff Ex. 12.0, ll. 163-168; Tr. p. 70, ll.16-20.

Especially as clarified at the hearing, Staff's objections are largely not related to PIP goals or results that lack tangible ratepayer benefits, but instead are related almost exclusively to the administration of the PIP program. It seems that if MidAmerican had established six quantitative goals with pre-determined levels of payouts for pre-determined goal achievements, the PIP would be acceptable to Staff as long as they were not net income goals, without further scrutiny of the ratepayer benefit from the goals. Such a program would certainly not result in any greater benefits than a program focusing on MidAmerican's six core principles, even if its formula made it easier to calculate. MidAmerican's PIP focuses on the six core principles, which encompass overall MidAmerican performance and clearly benefit customers. This overall focus is more likely to impact all aspects of employee performance, producing better results than a program of triggers and payouts.

MidAmerican responds to Staff's objections to allowance of PIP incentive compensation below.

(i) PIP compensation is discretionary or subjective in nature and based on goals with no direct payout percentage assigned

Staff's objections completely ignore that the six core principles of customer service, employee commitment, financial strength, environmental respect regulatory integrity and operational excellence drive every corporate and individual goal of MidAmerican. Each year, MidAmerican's President establishes overall MidAmerican goals based on the six core principles. MidAmerican Ex. MAG 1.0 at 6-7, ll. 109-126. Exhibit MAG 3.1, Sch. A lists each of the 39 goals relevant to the 2012 test period. A few illustrative goals are:

- Support a safe work environment for all employees and reduce incident rates to a level equal to the top 10% of the industry peer group (goal 1)
- Achieve top 10% performance on overall customer satisfaction and overall satisfaction with electric reliability, where applicable, in all residential, commercial and industrial customer satisfaction surveys (goal 19)
- Achieve customer and delivery service performance targets – time of response (goal 20)
- Implement a formal contractor safety incident tracking program (goal 5)
- Negotiate a multiyear coal rail transportation contract at a rate at or below forecast rates in the 10-year business plan for 2012-2021 (goal 29)
- Achieve Powder River Basin delivered coal cost target of $1.353/MMBtu (goal 37)
- Evaluate flood protection to high risk facilities by September 30, 2012 (goal 32)
- Reduce the number of preventable spills (goal 6)
- Reduce monthly customer complaints by 10%. On an ongoing basis, identify the top five customer complaint areas and develop and execute action plans to address those issues (goal 18)

- Complete the Illinois Commerce Commission National Electrical Safety Code corrective action plan by December 31, 2012 (goal 17)

Instead of assigning a rigid weight to each goal, at the end of the year, MidAmerican's President reviews total Company performance against all goals, each of which is anchored to a core principle, and then makes an overall determination of MidAmerican achievement. MidAmerican Ex. MAG 2.0 at 4, ll. 62-76. In turn, each manager receives a portion of the total company incentive pay to be granted to each employee based on performance to goals, each of which is anchored to a core principle. MidAmerican Exs. MAG 2.0 at 4-5, ll.77-89; MAG 2.1, Sch. D.

Staff objects to this approach, describing it as "absolutely subjective and discretionary" (Staff Ex. 3.0, l. 436) because there are no direct PIP incentive compensation payout percentages specifically assigned to any of the company-wide goals (Staff Ex. 12.0, ll. 92-93) or to individual employee goal accomplishments. Staff Ex. 12.0, ll. 99-100. Staff also objects that incentive pay was awarded although a handful of goals were not accomplished. Staff Ex. 12.0, ll. 93-97.

Staff misconstrues the discretionary aspect of MidAmerican's PIP. Where the PIP incentive is merely an element of a market-based compensation package, management's "discretion" regarding payout must be narrowly targeted if MidAmerican's compensation is to remain competitive. The fact that the payout has averaged 96% over the last eleven years strongly supports this conclusion.

In fact, MidAmerican's determination of incentive pay amounts is neither arbitrary nor subjective. From the development of the corporate goals to the time of corporate and individual evaluation, incentive pay amounts are clearly and consistently based on annual accomplishments of goals based on the six core principles. The major difference between the approach of the PIP and a "trigger" based approach is the ability of the incentive award to be based on overall corporate performance for the year instead of some subset of performance.[6] MidAmerican's approach allows the President to use reasoned judgment regarding company performance, which allows balancing of accomplishments in each of the six areas against one another. There is no "absolute discretion" by the President. Instead, all of his decisions revolve around the goals which in turn revolve around the core principles.

The MidAmerican goals are established and evaluated around acceptable metrics, not fixed improvements. *See* e.g., Staff Ex. 12.0, Att. RWB 11.02. It is preferable to base goals around acceptable metrics instead of fixed improvements. If a goal was based on a fixed payout, it is possible effort would cease at the level of required goal achievement instead of at maximum achievable outcome. MidAmerican has demonstrated in this case that using acceptable metrics for achievement of goals based on the six core principles has resulted in improvements over time to benefit the customer. *See* MidAmerican Ex. MAG 2.1, Schs. A, B and C, reflecting improvements in customer satisfaction, O & M per customer and safety incident rate.

Staff only considers incentive pay programs with percentages assigned to accomplishment of each goal. This approach emphasizes the way in which the program is administered with little or no consideration of whether an appropriate level of compensation is awarded given the circumstances of the year. It could also lead to MidAmerican putting a much smaller amount of pay at risk than is appropriate under market conditions.[7] The result of this would be on average higher overall base compensation amounts to be reflected in the revenue requirement. Consequently, Staff's rigid requirement of some formula based payout results in an

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[6] This approach allows consideration of changed circumstances of the year as well as challenges that arise that were not contemplated when goals were set. MidAmerican Ex. MAG 1.0 at 7, ll. 127-132.

[7] MidAmerican Ex. MAG 1.1, Schedule A shows that on average target incentive pay ranges from 6-20% depending on the pay grade of the employee.

incentive plan that could provide reduced customer benefits at a higher cost. The staff's position is not reasonable and should be rejected.

An example of the counterproductive and arbitrary nature of Mr. Bridal's proposed approach can be seen in Goal 35, exceed business unit budget goals. As shown in the President's analysis of goal achievements, budgeted delivery expenses were exceeded during 2012 because of storms. Staff Ex. 12.0, Att. A at 19. If a rigid approach was taken to goal accomplishment, there would be no ability to address goals within the context of key accomplishments and disappointments over the year. Certain conditions affecting utility performance cannot be known ahead of time. However, the Company's response to unforeseen conditions may be an indication of superior performance. The President's review of goal achievement allows the circumstances surrounding goal accomplishments to be properly considered. Another reason for applying discretion to goal achievement would be when regulatory directives change. For example, during 2012, the Cross State Air Pollution Rule was overturned. *Id.* at 6. That goal appeared important for the coming year, but became irrelevant after it was not put into effect. It would not have been appropriate to make an incentive pay award related to such goal, but a rigid system of payouts might have required it. Finally, in a year with significantly fewer storms than typical but poor company outage response times, the company would easily meet targeted interruption duration indices that are a MidAmerican goal. *Id.* at 12. With management discretion in goal performance analysis, the President can determine that the goal **was not** met (even though 2 of 3 or the majority of the targets were). Management needs to apply reasoned judgment to determine whether goals are achieved given circumstances that occurred during the year, not rely on triggers to determine at what level PIP should be paid.

The record demonstrates a clear connection between each of the six core principles underlying the PIP and the goals set for the overall company down to the individual level. The record also demonstrates substantial, uncontested accomplishments that primarily benefit customers and are clearly based on the six core principles, such as improvements in customer satisfaction and safety and reductions in O&M expense. That there is no year-to-year specific percentage tied to each of the goals of an incentive award should not override the benefits demonstrated from the program.

d. Based partially on financial performance

MidAmerican acknowledges that part of Staff's objection is to incentive awards based on a financial performance objective, and that the Commission has generally disallowed financial goals finding them to primarily benefit shareholders.[8] MidAmerican also recognizes that at the hearing Staff witness Bridal limited his objection to those goals under the financial strength core principle that are of the incomes or profit-margin nature. Tr. at 70, ll. 16-20, and not all goals associated with its financial strength core principle. Financial **strength** is not the same as a financial **performance** objective. MidAmerican's financial strength core principle is intended to ensure a company with adequate financial resources to meet customer requirements and should thus warrant consideration by the Commission as an appropriate part of allowable employee incentive compensation expense.

[8] The Commission's disallowance of incentive compensation based on financial performance goals has not been absolute. The Commission has authorized incentive compensation based on the PIP for MidAmerican in its most recent gas rate case, ICC Docket No. 09-0312. MidAmerican Ex. MAG 2.0, ll. 128-133. Disallowance of all or part of PIP compensation in this case will result in a mismatch between gas and electric revenue requirements.

e. Contains goals not associated with Illinois electric jurisdictional utility service

Because MidAmerican provides natural gas and electric service and is a multi-jurisdictional utility, many of the costs, expenses and revenues reflected in the revenue requirement must be allocated in order to get the proper jurisdictional amount. Staff has not expressed concern about the allocation factors used by MidAmerican to allocate these costs between gas and electric and to different jurisdictions, except in witness Bridal's rebuttal testimony where, for the first time in his rebuttal testimony, he suggests PIP expenses should be disallowed because certain corporate goals are not associated with Illinois utility service. Staff Ex. 12.0, ll. 112-122.

Since the core principles apply to all MidAmerican operations and the PIP measures performance of the entire company, there will be some goals that may not apply to all employee groups yet are important to overall company operations. This does not mean that costs unassociated with Illinois are being charged to Illinois customers. In fact, MidAmerican's proposed Illinois electric rates include only a relatively small portion of total incentive compensation. The total of incentive compensation pay is charged to jurisdictions based on a system of allocations based on the FERC and Commission systems of accounts that ensures appropriate costs will be charged to each jurisdiction. Moreover, it should be noted that the mix of goals related to specific jurisdictions is likely to change from year-to-year based on changing relative circumstances between jurisdictions.

Furthermore, goals related to specific jurisdictions are only a small part of the total. The majority of the 39 goals focus on total company operations and lead to an allocated cost. A list of the goals, describing each as whether or not they are operational in nature and will lead to an allocated payment in Illinois is included at MidAmerican Ex. 3.1, Sch. 1.

Had MidAmerican based its 2012 PIP goals on Staff's recommendation to exclude jurisdiction-specific performance, the result may actually have been detrimental to Illinois electric customers. Goal 17 is specific to Illinois and is intended to complete the Illinois Commerce Commission-ordered National Electrical Safety Code corrective action plan and complete it by December 31, 2012.

The overwhelming majority of goals under the six core principles for 2012 are operational in nature and their costs and compensation based on the results of achievement of these goals are allocated to each jurisdiction. There is no basis for disallowing a portion of these amounts due to a subjective concern.

f. Conclusion

The parties appear to agree that most of the goals associated with MidAmerican's PIP are reasonable. Tr. at 70, l. 3 through Tr. at 71, l. 2. If it was not for a limited number of goals to which Staff objects, the record demonstrates that Staff otherwise agrees in all respects with including PIP compensation in the revenue requirement to be determined in this proceeding. MidAmerican requests the Commission review the clear evidence of tangible ratepayer benefits, including those largely unrelated to shareholders such as customer satisfaction, and approve market level compensation for MidAmerican consisting of base and incentive pay. This produces a reasonable electric revenue requirement and is consistent with its natural gas revenue requirement approved by the Commission in Docket No. 09-0312.

2. Steam Production

MidAmerican proposed an adjustment to normalize maintenance costs for MidAmerican's coal units by adjusting test year values to five-year average values. Maintenance costs for MidAmerican's coal generation facilities can vary significantly from year to year depending upon where each of the units is with respect to its major maintenance cycle and the extensiveness of the maintenance performed. Five years was selected as the normalization period since these units are generally on a five-year cycle for major overhaul work. MidAmerican Ex. RRT 1.0 at 7, ll. 125-131.

MidAmerican included an inflation factor because a five year average of actual costs only reflects changes in the level or work activity, but the five year average ignores changes in cost levels for the work being performed over that period of time. MidAmerican Ex. RRT 1.0 at 7, ll. 133-134. Therefore, MidAmerican relied on the Handy-Whitman index in its calculations of these costs. Since the calculation was an average, the change in the index over the five years was averaged as well. *Id*. at 135-139.

MidAmerican and Staff agree that normalizing steam production maintenance costs is appropriate and reasonable. MidAmerican Ex. RRT. 2.0 at 4, ll. 60-61; Staff Ex. 3.0 at 5. MidAmerican accepted Staff's adjustments regarding the application of the inflation factors to normalize these costs. MidAmerican Ex. RRT 2.0 at 3-4, ll. 40-47.

MidAmerican agreed with the DOD position that there is an element of duplication with the adjustments for steam production maintenance for labor and the payroll pro forma adjustment to the extent of the labor costs that are embedded in steam production maintenance. Accordingly, MidAmerican proposed a modification to the payroll tax adjustment to remove any escalation associated with payroll charged to steam production maintenance. MidAmerican Ex. RRT 2.0, at 7, ll. 119-124. Staff agreed with MidAmerican's adjustment. Staff Ex. 12 at 2, ll. 45-46; at 18-19, ll. 407-411.

The DOD, however, continues to recommend the Commission reject the normalization of steam production costs. This position fails to consider that the normalization of costs has been a long-accepted practice by the Commission and is relevant for the types of costs that are volatile from year-to-year, as is the case with steam production and distribution maintenance costs. The methodology to normalize these costs proposed by MidAmerican, as adjusted by Staff, is a reasonable approach to achieve such normalization for steam production costs. Accordingly, in keeping with the traditional treatment the Commission has relied upon in ratemaking treatment of steam production maintenance costs, the Commission should adopt MidAmerican's steam production maintenance costs.

3. Distribution Maintenance

MidAmerican proposed an adjustment to normalize maintenance costs for MidAmerican's electric distribution system by adjusting test year values to five-year average values. Distribution costs can vary significantly from year to year due to the occurrence of storms, flooding or other unpredictable circumstances. A multi-year average of such costs smooths the impact of such occurrences. Five years was used to be consistent with the approach used with steam maintenance. A distribution plant inflation index was used in the calculation for the same reasons outlined above for steam maintenance. MidAmerican Ex. RRT 2.0, at 8, ll. 142-149.

MidAmerican included an inflation factor because a five year average of actual costs only reflects changes in the level or work activity, but the five year ignores changes in cost levels for the work being performed over that period of time. MidAmerican Ex. RRT 1.0 at 7, ll. 133-134. Therefore, MidAmerican relied on the Handy-Whitman index in its calculations of these costs. Since the calculation was an average, the change in the index over the five years was averaged as well. *Id.* at ll. 135-139.

MidAmerican and Staff agree that normalizing steam distribution maintenance costs is appropriate and reasonable. MidAmerican Ex. RRT. 2.0 at 4, ll. 60-61; Staff Ex. 3.0 at 5.

MidAmerican accepted Staff's adjustments regarding the normalization of these costs. MidAmerican Ex. RRT 2.0 at 3-4, ll. 40-47.

MidAmerican agreed with the DOD position that there is an element of duplication with the adjustments for distribution maintenance labor and the payroll pro forma adjustment to the extent of the labor costs that are embedded in distribution maintenance costs. Accordingly, MidAmerican proposed a modification to the payroll tax adjustment to remove any escalation associated with payroll charged to distribution maintenance. MidAmerican Ex. RRT 2.0 at 7, ll. 119-124. Staff agreed with MidAmerican's adjustment. Staff Ex. 12 at 2, ll. 45-46; at 14-15, ll. 320-328; at 16, ll. 364-368.

The DOD, however, continues to recommend the Commission reject the normalization of distribution maintenance costs. This position fails to consider that the normalization of costs has been a long-accepted practice by the Commission and is relevant for the types of costs that are volatile from year-to-year, as is the case with distribution maintenance costs. The methodology to normalize these costs proposed by MidAmerican, as adjusted by Staff, is a reasonable approach to achieve such normalization for distribution maintenance costs. Accordingly, in keeping with the traditional treatment the Commission has relied upon in ratemaking treatment of distribution maintenance costs, the Commission should adopt MidAmerican's distribution maintenance costs.

4. <u>State Income Tax Rate Decrease</u>

Staff presented an adjustment to reflect, what Staff characterizes as a known and measureable change in the Illinois corporate income tax rate, effective January 1, 2015. Staff Ex. 10.0 at 5, ll. 87-89.

The Commission should reject this adjustment for several reasons. First, the Illinois state income tax change is not a known and measurable change because it occurs outside the twelve month period from date of filing that is generally accepted as the timeframe to quantify known and measurable changes to test year data. MidAmerican Ex. RRT 3.0 at 3, ll. 39-41. MidAmerican's tariffs were filed on December 16, 2013. If the Commission reaches out beyond this twelve month period, as suggested by Staff, it is necessary for the Commission to also reach out beyond such period to quantify additional pro forma adjustments, including contractually scheduled pay rate increases for union employees, contractually scheduled escalations for coal transportation costs that begin beyond 2014, or additions to rate base to be placed in service beyond 2014 to be consistent and match all revenues with expenses. *Id.*, ll. 44-46.

Moreover, as a procedural matter, Staff's adjustment raises an issue not addressed in direct testimony by any witness and it is not appropriate to raise new issues on rebuttal. *Id.*, ll. 37-39.

Third, Staff's proposed change is not known. The Illinois General Assembly considered a proposal to delay the scheduled drop in the tax rate in its latest session, but that proposal was rejected. Given the current budgetary situation of the State of Illinois, it is not unreasonable to expect such a proposal to be raised again in the fall session and pass prior to the scheduled effective date of the rate change. MidAmerican Ex. RRT 3.0 at 3-4, ll. 37-51.

Accordingly, Staff's adjustment is improper as it violates the matching principle, is contrary to the Commission's rules and is unreasonable. Therefore, the Commission should reject Staff's adjustment.

5. Rate Case Expenses

Illinois law is clear that a utility is entitled to recover rate case expenses. The Illinois Supreme Court defines these expenses as ordinarily, properly and fairly allowable as an operating expense. *DuPage Util. Co. v. Illinois Commerce Comm'n*, 47 Ill. 2d 550, 553, 561 (1971) (holding that "just and reasonable" rates "should be sufficient to provide for operating expenses" and that "rate-case expense is ordinarily properly and fairly allowed as an operating expense"). *See also People ex rel. Lisa Madigan v. Illinois Commerce Comm'n*, 2011 IL App (1st) 101776, ¶ 13 (1st Dist. Dec. 9, 2011, *reh'g denied*, April 11, 2012) ("*Madigan*"), *appeal denied* (Ill. S. Ct. Sept. 26, 2012) ("Illinois courts have allowed utilities to recover rate case expense because "[t]he costs incurred by a utility to prepare and present a rate case are properly recoverable as an ordinary and reasonable cost of doing business.") (*quoting Central Illinois Public Service Co. (CIPS) v. Illinois Commerce Comm'n*, 243 Ill. App. 3d 421, 432 (4th Dist. 1993) (*citing DuPage*)); *Driscoll v. Edison Light & Power Co.*, 307 U.S. 104, 120-121 (1939) ("[O]n a proceeding by a commission to determine reasonableness [or rates], we are of the view that the utility should be allowed its fair and proper expenses for presenting its side to the commission."). Consequently, MidAmerican's costs incurred to prepare and present a rate case are properly recoverable as an ordinary and reasonable cost of doing business.

Section 9-229 of the Act, 220 ILCS 5/9-229, also recognizes the recoverability of rate case expenses:

> The Commission shall specifically assess the justness and reasonableness of any amount expended by a public utility to compensate attorneys or technical experts to prepare and litigate a general rate case filing. This issue shall be expressly addressed in the Commission's final order.

The evidentiary record contains substantial evidence demonstrating that MidAmerican's revised proposed rate cases expenses relating to its outside witness are just and reasonable. Moreover, the record evidence is more than sufficient for the Commission to specifically assess the justness and reasonableness of those expenses as required by Section 9-229 of the Act, 220 ILCS 5/9-229. As the record demonstrates and as is explained below, MidAmerican's rate case expenses for its one outside witness are just and reasonable and consistent with Section 9-229 of the Act.

a. Rate Case Expenses for Outside Return On Equity Witness Expense are Reasonable

MidAmerican presented evidence demonstrating that Dr. James Vander Weide, President of Financial Strategy Associates and a Research Professor of Finance and Economics at the Fuqua School of Business of Duke University, provided expert analysis and testimony regarding the recommended return on equity for MidAmerican. Dr. Vander Weide is a respected cost of capital expert, with many scholarly publications, a distinguished academic career, and a wealth of experience within the utility industry.

MidAmerican presented evidence that it does not have an employee who is a cost of capital expert. MidAmerican Ex. DLK 2.0 at 7, ll. 135-138; and MidAmerican Ex. DAC 2.0 at 3, l. 23. MidAmerican explained that the expertise required is very specialized, often necessitating an advanced college degree; and the frequency in which the expertise is needed has not justified having an employee with this skill set on staff. *Id.*, DAC 2.0, ll. 23-28. Mr. Crist testified that from his thirty-six years of experience, he believes it is the norm for utilities to retain such expertise for rate cases on an as needed basis from an outside expert. MidAmerican Exs. DAC 1.0 at 2, l. 9, and DAC 2.0 at 3, ll. 26-28.

Staff witness Kahle also agreed on cross examination that it is typical for utilities to engage an outside witness for ROE issues and also acknowledged that Dr. Vander Weide's work was not duplicated by MidAmerican personnel. Tr. 57, ll. 4-12.

Despite this acknowledgement, Staff contends that the MidAmerican's engagement letter with Dr. Vander Weide is insufficient and that retaining an outside consultant without preparing a written contract is not just or reasonable within the meaning of Section 229 of the Act. Staff Ex. 5.0 at 10, ll. 218-223.

MidAmerican respectfully disagrees. MidAmerican and Dr. Vander Weide do have a written contract as shown in Staff Ex. 5.0, Att. A. The contract clearly defines the scope of work in the paragraph entitled Work. The contract defines the fee and specifies the dollar per hour for services and reimbursement of expenses. While this agreement was orally amended to expand the scope for the Illinois rate case, there is none the less, a written contract. The contract does not require that any changes to the agreement must be in writing.

Except for agreements governed by the statute of frauds, Illinois law allows a written contract to be modified by subsequent oral agreements. *See Krautsack v. Anderson,* 329 Ill.App.3d 666, 768 N.E.2d 133, 147, 263 Ill. Dec. 373 (1st Dist. 2002). Oral modifications must be proved through extrinsic evidence and generally present issues of fact. *E.A. Cox Co. v. Road Savers International Corp.,* 271 Ill.App.3d 144, 648 N.E.2d 271, 277, 207 Ill. Dec. 815 (1st Dist. 1995); *A.W. Wendell & Sons, Inc. v. Qazi,* 254 Ill.App.3d 97, 626 N.E.2d 280, 287–288, 193 Ill. Dec. 247 (2d Dist. 1993).

While there is no contract dispute in this case, the evidence does demonstrate that nothing in the engagement letter precludes an oral amendment, therefore, the statute of frauds does not prevent an oral amendment. As MidAmerican explained in testimony, there were several reasons an oral amendment was sufficient in this case.

First and foremost is the longstanding relationship with Dr. Vander Weide and his knowledge about MidAmerican and its predecessor companies. It is reasonable to retain an expert who has a solid understanding of MidAmerican's operations. MidAmerican Ex. DAC 2.0 at 4, ll. 64-67. Mr. Crist testified that he, along with MidAmerican's general counsel and two of the Company's senior management team directing this case, agreed to extend the witness' agreement under the same terms and conditions to work needed for the Illinois electric rate case.

Id., ll. 67-70. Given the work already performed in the previous Iowa cases, extending the engagement to include the Illinois rate case was an obvious, prudent step to take. MidAmerican determined reasonable charges for this type of work. *Id.*, ll. 71-75. The Iowa rate case was filed on May 17, 2013, and the Illinois rate case was filed on December 16, 2013. To stop and ask for proposals to do the same work in Illinois would have meant duplicating what had already been done for the Iowa case and be a waste of expenses.

Additionally, MidAmerican has had a long relationship with the outside witness, Dr. Vander Weide. MidAmerican Ex. DAC 2.0 at 5, ll. 76-77. The cost per hour on the invoices for the Illinois work is the same price as the Iowa engagement letter proving that Dr. Vander Weide is charging that same price that MidAmerican approved with the oral amendment. This was verified when Staff witness McNally reviewed Dr. Vander Weide's invoices and Mr. McNally did not propose any adjustments in his direct testimony. Staff. Ex. 6.0 at 17, ll. 344-349. Moreover, during cross examination, Staff witness Kahle also verified the expenses for the outside witness were consistent with the engagement letter. Tr. at 59, ll. 3-25 through 60, ll. 1-14.

Moreover, under Illinois law, parties do not form a new contract every time an original contract is somehow altered or amended. Instead, "courts observe whether the contractual modifications were significant enough to change the parties' obligations under the particular contract." *Nebel, Inc. v. Mid-City National Bank of Chicago,* 329 Ill.App.3d 957, 769 N.E.2d 45, 53, 263 Ill. Dec. 843 (1st Dist. 2002).

In this case, MidAmerican demonstrated that the amendment to include Illinois return on equity testimony was not significant enough to change the either MidAmerican's obligations or Dr. Vander Weide's obligations under the contract. The performance for the Illinois rate case was identical to the performance for the Iowa cases. Additionally, there is no issue that the contract clearly defines the scope of work and the fee and specifies the dollar per hour for services and reimbursement of expenses. MidAmerican expected and has paid for his services in accordance with the rates specified in that agreement. As noted above, Staff confirmed that the services performed by Dr. Vander Weide were consistent with the terms set forth in the engagement letter. Tr. at 59, ll. 3-25 through 60, ll. 1-14.

Therefore, there is no issue in this case that the performance of this work was consistent with the contract. The record demonstrates there was a contract in place for Dr. Vander Weide, Staff agreed on cross examination that engagement letter for Dr. Vander Weide's services being provided, cost of capital studies, testimony, data request responses and litigation for the Illinois case are consistent with the scope of work discussed in the engagement letter. While Mr. Kahle acknowledged that the services were the same other than the fact the engagement letter referenced Iowa, this is not a reason to deny the rate case expense.

The contract amendment was consistent with law and the work performed was also consistent with the engagement letter. Furthermore, Section 9-229 does not require that the Commission review include review of a specific contract to make its determination. In the *Madigan* case, the court found:

> While we make no finding as to the amount of attorney and expert fees requested, we point the Commission to other cases involving an award of attorney fees, in which the party seeking attorney fees must specify (1) the services performed, (2) by whom they were performed, (3) the time expended, and (4) the hourly rate charged. *Fitzgerald v. Lake Shore Animal Hospital, Inc.*, 183 Ill. App. 3d 655, 661 (1989) (citing *Kaiser v. MEPC American Properties, Inc.*, 164 Ill. App. 3d 978, 984 (1987)).
>
>> "Once presented with these facts, the trial court should consider a variety of additional factors such as the skill and standing of the attorneys, the nature of the case, the novelty and/or difficulty of the issues and work

> involved, the importance of the matter, the degree of responsibility required, the usual and customary charges for comparable services, the benefit to the client [citation], and whether there is a reasonable connection between the fees and the amount involved in the litigation [citations]." *Kaiser*, 164 Ill. App. 3d at 984.
>
> Similar to cases before the trial court, the Commission has the ability to consider the factors presented to establish the amount of attorney fees requested. We believe that these cases regarding an award of attorney fees can provide guidance to the Commission and the parties to comply with section 9-229.
>
> *Madigan* at ¶¶51-52.

The relevance of whether an engagement letter was expanded by verbal agreement or by written agreement does not change the fact that MidAmerican presented evidence regarding the nature of the services, the time expended and the hourly rate charged. All of these factors were consistent with the engagement letter. Moreover, given the multiple rate cases in different jurisdictions, MidAmerican was able to create efficiencies by engaging the same witness to perform services for rate cases filed within the same year but in different jurisdictions.

Conclusion

For the reasons stated above, Staff's adjustment to remove rate case expenses for MidAmerican's technical witness is unreasonable and contrary to the record evidence. The effect of denying cost recovery would be to not allow MidAmerican to recover an appropriate and reasonable rate case expense. Consistent with the law, MidAmerican has presented evidence that (i) Dr. Vander Weide preformed services presenting ROE testimony and its associated defense during litigation; (ii) the time Dr. Vander Weide expended on the case and his hourly charge; and (iii) Dr. Vander Weide's qualifications as an ROE witness. Accordingly, there is sufficient evidence for the Commission to make a specific finding that $181,000, including $70,000 for the technical expert, of rate case expenses should be included in the revenue requirement and amortized over five years because they are just and reasonable.

V. Rate of Return

A. Overview

MidAmerican, Staff and DOD agree upon most of the components of MidAmerican's rate of return. There are no issues relating to MidAmerican's proposed capital structure and cost of debt. Disagreement, however, remains regarding the authorized rate of return on common equity ("ROE").

MidAmerican proposes a rate of return on rate base of 7.721% based upon a capital structure consisting of 48.270% long term debt at a cost of 5.48%, and 51.730% common equity at a cost of 10.70%. MidAmerican Ex. JHV 1.0 at 5, ll.71-74, MidAmerican Sch. D-1.

Staff proposes a rate of return on rate base of 7.14% based upon a capital structure and cost of debt presented by MidAmerican, but recommends the cost of common equity be set at 9.56%. Staff Ex. 6.0 at 33, ll. 662-665, Sch. 6.01.

DOD proposes a rate of return on rate base of 6.98% based upon a capital structure and cost of debt presented by MidAmerican, but recommends the cost of common equity be set at 9.40%. DOD Ex. MPG 1.0 at 9, ll. 191-193, DOD Ex. MPG 1.1.

The cost of equity, that is, the return MidAmerican is allowed to earn on the equity portion of its capital structure, is one of the most critical elements of the revenue requirement, and, as in this case, it is often the most disputed. The cost of equity capital represents the return investors expect to receive on alternative equity investments of comparable risk. MidAmerican Ex. JHV 1.0 at 7, ll.114-115; *see also* Staff Ex. 6.0 at 20-21, ll. 429-432; DOD Ex. MPG 1.0 at 9, ll. 197-199. While the parties agree on what the cost of common equity means, there is disagreement over how it is calculated. MidAmerican presented the testimony of Dr. James

Vander Weide. Dr. Vander Weide estimated the cost of equity for MidAmerican by applying several standard cost of common equity methods to market data for a large group of utility companies of comparable risk to MidAmerican. MidAmerican Ex. JHV 1.0 at 3, ll. 41-43. Based on the evidence he presents, Dr. Vander Weide determined that MidAmerican cost of equity for comparable companies is 10.70%. *Id.* at 4, ll. 64-65. As explained further below, MidAmerican has presented a reasonable ROE reflecting the return investors expect to receive on equity investments of comparable risk. Accordingly, the Commission should adopt Dr. Vander Weide's recommended ROE of 10.70% for MidAmerican.

B. Capital Structure

MidAmerican presented a capital structure consisting of 48.270% long term debt and 51.730% common equity as of September 30, 2013. MidAmerican Sch. D-1, *see also* MidAmerican Ex. RRT 1.0 at 13, ll. 262-267. MidAmerican used September 30, 2013, to measure its capital structure for several reasons. First, capital transactions occurred in 2013 that impact the cost of capital, including a common dividend in January 2013, redemption of all outstanding preferred stock in April 2013 and issuance of long-term debt in September 2013 to, in large part, fund the December 2013 payment of deferred costs under a contract with Siemens that is accounted for as long-term debt. *Id.* at 14. Second, a fair amount of time has elapsed since the end of 2012 and the calculation as of September 30, 2013 reasonably updates the calculation with more current values. *Id.* Third, a number of rate base pro forma adjustments are included in MidAmerican's case, and an updated cost of capital more consistently matches the pro forma rate base. *Id.*

DOD and Staff agreed with MidAmerican's proposed capital structure. Staff Ex. 6.0 at 18, ll. 383-384; DOD Ex. MPG 1.0 at 9, ll. 191-193. Deere did not take a position on this issue.

C. Cost of Long Term Debt

MidAmerican presented a calculation of the cost of long-term debt at September 30, 2013 that includes annual interest costs, amortization of long-term debt discount, issuance expense, annual amortization of gains and losses on reacquired debt, and the relative percentages of each component of long-term debt in MidAmerican's capital structure, arriving at a cost rate equal to 4.528%. MidAmerican Ex. RRT 1.0 at 15, ll. 295-299.

DOD and Staff agreed with MidAmerican's proposed cost of long term debt. Staff Ex. 6.0 at 18, ll. 383-384; DOD Ex. MPG 1.0 at 9, ll. 191-193. Deere did not take a position on this issue.

D. Cost of Common Equity

As noted above, the parties are in general agreement regarding how to define the cost of equity. The contested issues in this case center around the methods for estimating the cost of equity and the market data relied upon to develop those methods.

Dr. Vander Weide used several generally accepted methods for estimating the cost of equity including the Discounted Cash Flow Method ("DCF"), the Capital Asset Pricing Model ("CAPM"), and the risk premium method. MidAmerican Ex. JHV 1.0 at 18, ll. 385-388. Dr. Vander Weide applied these methods to market data for a large group of utility companies of comparable risk. MidAmerican Ex. JHV at 3, ll. 41-43. Since the DCF, risk premium and CAPM require inputs that are not easily measured, the inputs must be estimated. *Id.* at 4, ll. 49-50. While this estimation can cause some degree of uncertainty surrounding the estimate of the cost of equity, the uncertainty in the estimate of the cost of equity for an individual company can be greatly reduced by applying cost of equity methods to a large sample of comparable companies. *Id.*, ll. 51-53. A large sample allows the unusually high estimates for some individual companies to be offset by unusually low estimates for other individual companies. *Id.*, ll. 54-55. Consequently, Dr. Vander Wiede applied the cost of equity methods to large proxy groups of comparable electric companies. *Id.*, ll. 51-53; at 25, ll. 561-566; ll. 586-587, and Sch. 1.

In utility regulation, the practice of using a group of comparable companies, called the comparable company approach, is further supported by the United States Supreme Court standard that the utility should be allowed to earn a return on its investment that is commensurate with returns being earned on other investments of the same risk. *Id.*, ll. 57-61. These tried and true standards were set out by the United States Supreme Court in *Bluefield Water Works & Improvement Co. v. Public Service Comm'n of the State of West Virginia*, 262 U.S. 679 (1923) (*Bluefield*) and *Federal Power Comm'n v. Hope Natural Gas Co.,* 320 U.S. 591, 603 (1944) (*Hope*) cases.

In *Bluefield*, 262 U.S. at 692, for example, the Court stated:

> A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.

In *Hope*, 320 U.S. at 603, Justice Douglas, writing for the Court, stated:

> From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. . . . By that standard the return on equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.

More importantly, the Commission has found that these two cases "support the ratemaking principles applied by this Commission." *In re Consumers Ill. Water Co.,* ICC Docket 03-0403, Order at 41 (April 13, 2004). With these standards or ratemaking principles in mind, MidAmerican recommends a cost of equity of 10.70%.

1. <u>The Use of a Larger Proxy Group Reduces the Uncertainty in the ROE Estimate</u>

Dr. Vander Weide used large groups of comparable risk electric utilities to apply to his cost of equity methodologies to reduce the uncertainty in the ROE estimate. Staff started with the same proxy group of 28 electric utilities Dr. Vander Weide used in his DCF method, but reduced its sample using two factors to screen Dr. Vander Weide's proxy group. Staff's screening eliminated 16 companies, reducing Staff's proxy group to just 12 comparable companies. Staff Ex. 6.0 at 20-22, ll. 428-475. DOD also used the same proxy group as Dr. Vander Weide, but eliminated one company, TECO, because it was involved in merger and acquisition activity. DOD Ex. MPG 1.0 at 10-11, ll. 220-230.

As noted above, the inputs in cost of equity methods are uncertain, and hence, must be estimated. To reduce the uncertainty in estimating the cost of equity, it is reasonable to apply cost of equity methods to a large sample of comparable risk companies. MidAmerican and DOD both use a large sample, but Staff, on the other hand, reduced its sample based Edison Electric Institute's ("EEI") data on the percent of regulated assets for each utility in 2012 and on Standard & Poor's bond ratings, ignoring other factors that may differentiate the risk of one electric utility from another, such as differences in generation mix, forecasted capital expenditures; age of generation, transmission and distribution assets; customer mix; population growth and density in the service area; expenditures required to meet new environmental-related regulation; economic health of the service territory; and state laws and regulations. MidAmerican Ex. JHV 2.0 at 3, ll. 48-53. Because Staff's data on percent regulated assets for 2012 and bond ratings do not reflect differences in the risk of investing in the equity of one utility compared to another, the Commission should rely on MidAmerican's larger proxy group to determine MidAmerican's cost of equity.

Additionally, there is no reasonable basis for Staff to eliminate electric utilities from that proxy group that are not within one notch of MidAmerican's 'A-' rating since bond rates related to the risk that a company will default on the payment of interest and principal on its bonds. MidAmerican Ex. JHV 2.0 at 8, ll. 178-179. Equity investors, on the other hand, are concerned with the variability in the return on their equity investment. *Id.* ll. 180-181. Consequently, equity risk is different from bond risk and bond ratings are a poor indicator of the risk of investing in a company's equity. *Id.*, ll. 80-181. Indeed, as Dr. Vander Weide demonstrates, the average allowed return on equity for electric utilities is approximately the same regardless of the company's bond rating. MidAmerican Ex. JHV 3.0 at 7, ll. 126-134.

The Commission should recognize that Staff's recommendation is based on a small proxy group which creates uncertainty in Staff's recommended ROE estimate.

2. Discounted Cash Flow Model

Dr. Vander Weide explained that the DCF model is based on the assumption that investors value an asset because they expect to receive a sequence of cash flows from owning the asset. Thus, investors value an investment in a bond because they expect to receive a sequence of semi-annual coupon payments over the life of the bond and a terminal payment equal to the bond's face value at the time the bond matures. Likewise, investors value an investment in a firm's stock because they expect to receive a sequence of dividend payments and, perhaps, expect to sell the stock at a higher price sometime in the future. MidAmerican Ex. JHV 1.0 at 18-19, ll. 402-409.

A second fundamental principle of the DCF method is that investors value a dollar received in the future less than a dollar received today. A future dollar is valued less than a current dollar because investors could invest a current dollar in an interest earning account and increase their wealth. This principle is called the time value of money.[9]

Staff, MidAmerican and DOD all applied the quarterly DCF model in their respective ROE analysis. *See generally*, MidAmerican JHV 1.0 at 18-26, ll. 401-587; Staff Ex. 6.0 at 22, ll. 472-486; DOD Ex. MGP 1.0 at 12-16, ll. 258-346. DOD, however, used two other DCF models, the multi-stage growth and the sustainable growth models. The DOD's DCF result of 9.15% is

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[9] Applying the two fundamental DCF principles noted above to an investment in a bond leads to the conclusion that investors value their investment in the bond on the basis of the present value of the bond's future cash flows. Thus, the price of the bond should be equal to:

Equation 1

$$P_B = \frac{C}{(1+i)} + \frac{C}{(1+i)^2} + \ldots + \frac{C+F}{(1+i)^n}$$

where:
P_B = Bond price;
C = Cash value of the coupon payment (assumed for notational convenience to occur annually rather than semi-annually);
F = Face value of the bond;
i = The rate of interest the investor could earn by investing his money in an alternative bond of equal risk; and
n = The number of periods before the bond matures.

Applying these same principles to an investment in a firm's stock suggests that the price of the stock should be equal to:

Equation 2

$$P_s = \frac{D_1}{(1+k)} + \frac{D_2}{(1+k)^2} + \ldots + \frac{D_n + P_n}{(1+k)^n}$$

where:

P_S = Current price of the firm's stock;
D_1, D_2...D_n = Expected annual dividend per share on the firm's stock;
P_n = Price per share of stock at the time the investor expects to sell the stock; and
k = Return the investor expects to earn on alternative investments of the same risk, i.e., the investor's required rate of return.

Equation (2) is frequently called the annual discounted cash flow model of stock valuation. Assuming that dividends grow at a constant annual rate, g, this equation can be solved for k, the cost of equity. The resulting cost of equity equation is $k = D_1/P_s + g$, where k is the cost of equity, D_1 is the expected next period annual dividend, P_s is the current price of the stock, and g is the constant annual growth rate in earnings, dividends, and book value per share. The term D_1/P_s is called the expected dividend yield component of the annual DCF model, and the term g is called the expected growth component of the annual DCF model.

derived by using the midpoint of both the average and median estimates of all three DCF models. DOD Ex. MPG 1.0 at 25, ll. 523-526. The DOD concedes that the Commission's standard practice is to use the quarterly DCF model, although DOD disagrees with the Commission's standard practice. DOD Ex. 1.0 at 13, ll. 278-289. MidAmerican notes that both Staff and Dr. Vander Weide relied on the average DCF results for the comparable companies, whereas the DOD also relied on the median DCF results for the comparable companies. The DOD's use of median results, in addition to average results, causes them to recommend a lower ROE. It would be reasonable for the Commission to reject both the DOD DCF results based on median values, and the DOD's multi-stage and sustainable growth DCF results. The average DCF result for the DOD's quarterly DCF model is 9.63%.

In summary, MidAmerican's DCF recommendation is based on a large proxy group, a proxy group nearly identical to DOD's proxy group, and is based on inputs that are consistent with market data generally relied upon by investors. *See generally* MidAmerican JHV 1.0 at 18-26, ll. 401-587. Thus, in considering the impact of DCF results on the determination of an appropriate allowed ROE for MidAmerican, the Commission should rely on Dr. Vander Weide's 9.9% DCF result.

3. MidAmerican's CAPM inputs are consistent with economic theory and appropriately estimate the ROE.

The CAPM is an equilibrium model in which the expected rate of return on an equity investment in a company is equal to a risk-free rate of interest, plus an expected risk premium, where the expected risk premium is the product of a company-specific risk factor, or beta, and the expected risk premium on the market portfolio of all securities. MidAmerican Ex. JHV 2.0 at 11, ll. 213-218. The fair rate of return standard requires that a company have an opportunity to earn its required return on its investment during the forward-looking period during which rates will be in effect. Because current interest rates are depressed as a result of the Federal Reserve's extraordinary efforts to keep interest rates low in order to stimulate the economy, current interest rates at this time are a poor indicator of expected future interest rates. *Id.* at 12, ll. 242-245. Economists project that future interest rates will be higher than current interest rates as the Federal Reserve allows interest rates to respond to market forces as the unemployment rate falls to normal levels. *Id.*, ll. 245-248. Thus, the use of forecasted interest rates is consistent with the fair rate of return standard, whereas the use of current interest rates at this time is not. *Id.*, ll. 248-249.

Dr. Vander Weide considered these factors to determine what risk free rate and company specific beta to input into the CAPM. Staff on the other hand did not take these factors into consideration. As a result, Staff's CAPM recommendation should be rejected because it ignores the recent extraordinary efforts of the Federal Reserve to keep interest rates low and do not reflect MidAmerican's opportunity to earn its required return on its investment during the forward-looking period during which rates will be in effect. If Staff had employed a forward looking risk free rate based on the forecasted yield on long-term Treasury Bonds of 5.17, then Staff's CAPM analysis would have produced a cost of equity of 10.10%. Had Staff also attempted to reduce the uncertainty in its estimate, Staff should have relied on a larger proxy group. MidAmerican Ex. JHV 2.0 at 13, ll. 262-271. Had Staff used the 28 company proxy group, Staff's utility beta would have been 0.73, and using the appropriate risk free of 5.17 would have yielded a CAPM result of 10.50%. MidAmerican Ex. JHV 2.0 at 14-15, ll. 274-301.

Staff's adjusted CAPM results are within the range of the historical and DCF-based CAPM results of 10.30% and 10.70% developed by Dr. Vander Weide. Although Dr. Vander Weide has presented evidence the CAPM tends to underestimate the cost of equity for companies whose equity beta is less than 1.0, MidAmerican recognizes that the Commission has traditionally relied on the results of the CAPM model. See generally MidAmerican Ex. JHV 1.0 at 38-43. Therefore, it is reasonable for the Commission to consider a CAPM range of 10.10% to 10.60%, which includes Staff's adjusted CAPM range of results of 10.10% to 10.50% and Dr. Vander Weide's average CAPM result of 10.60%. MidAmerican Ex. JHV 1.0 at 44; MidAmerican Ex. JHV 2.0 at 13 and 15.

MidAmerican notes that it is reasonable for the Commission to disregard DOD's CAPM result since the DOD acknowledges that its analysis is "conservative" and employs a risk free rate much lower than Value Line and the Energy Information Administration's forecasted risk free rate of 5.17%. MidAmerican Ex. JHV 2.0 at 27, ll. 567-577. Furthermore, DOD's CAPM recommendation does not take into consideration that the CAPM underestimates the cost of equity for companies with betas less than 1.0, and hence underestimates MidAmerican's cost of equity.

4. <u>Relying on the Results of the Risk Premium Models is Reasonable</u>

Dr. Vander Weide was the only witness in this case that conducted an ROE analysis using the Risk Premium Method. The risk premium method is based on the principle that investors expect to earn a return on an equity investment that reflects a "premium" over the interest rate they expect to earn on an investment in bonds. This equity risk premium compensates equity investors for the additional risk they bear in making equity investments versus bond investments. MidAmerican Ex. JHV 1.0 at 27, ll. 596-603.

Dr. Vander Weide's risk premium methods yielded results of 11.20% using the ex ante risk premium method and 10.90% using the ex post risk premium method. MidAmerican Ex. JHV 1.0 at 44; MidAmerican Ex. JHV 2.0 at 16, ll. 327-331. MidAmerican acknowledges that both of these estimates include flotation costs. Without the flotation costs, the ex ante and ex post risk premium methods would produce 11.00% and 10.70% estimates of the cost of equity.

The purpose of a risk premium analysis is to estimate the required return on investment for companies that are comparable in risk to the utility whose cost of equity is being estimated. MidAmerican Ex. JHV 2.0 at 17, ll. 343-356. Staff criticizes Dr. Vander Weide's risk premium analyses because the composition of his proxy group changes over time and because his analysis relies in part on historical risk premium data. These criticisms are misplaced. Staff Ex. 6.0 at 11, ll. 219-222.

Although the composition of the comparable companies in Dr. Vander Weide's risk premium analyses may change over time, at each point time, they are the largest possible group of comparable risk utilities with sufficient data to estimate the risk premium cost of equity. Consequently, there is no reason to believe that the changing composition of comparable utilities has a significant impact on the risk premium analyses of MidAmerican's cost of equity.

Additionally, it is reasonable for the Commission to review historical information on utility investors' required return on equity because the cost of equity can only be estimated with uncertainty, and the required risk premium on utility equity investments varies inversely with interest rates, *i.e.*, the required equity risk premium is higher when interest rates are lower, as they are at present, than when interest rates are higher. MidAmerican Ex. JHV 2.0 at 18, ll. 361-366. The Commission should recognize that the inverse relationship between the required risk premium on utility investments and interest rates can only be determined using historical data. By providing relevant information on the inverse relationship between the required risk premium and interest rates, Dr. Vander Weide's ex ante risk premium approach provides context in estimating MidAmerican's cost of equity that is not included in the DCF and CAPM studies. MidAmerican Ex. JHV 2.0 at 18, ll. 336-370.

Furthermore, it is widely recognized that investors' current expectations of the required risk premium are influenced in part by the historical record of the earned risk premium on stock investments of comparable risk. Thus, the ex post risk premium results also provide the Commission useful information for determining MidAmerican's cost of equity in this proceeding. MidAmerican Ex. JHV 2.0 at 18, ll. 371-375. Because past experience may impact future expectations, the ex post risk premium approach is relevant to an assessment of investor expectations, and accordingly is not outdated.

Based on the foregoing reasons, it is reasonable for the Commission to give weight to the results of the risk premium models presented in Dr. Vander Weide's testimony.

5. Conclusion

MidAmerican has demonstrated that its recommended a return on equity of 10.70% is commensurate with that of comparable risk enterprises; will maintain its financial integrity; and, will allow it to attract capital on reasonable terms. *See Hope* and *Bluefield.* An allowed return on equity for MidAmerican's Illinois electric utility operations of 10.70%, as indicated by the DCF, CAPM, and equity risk premium tests presented in Dr. Vander Weide's testimony, is reasonable and relies on market data investors would consider when applying the DCF, CAPM and equity risk premium tests. The resulting recommendation including MidAmerican's flotation costs will ensure MidAmerican maintains its financial integrity, will be able to attract capital on reasonable terms and will be afforded the opportunity to earn a return commensurate with the returns available to enterprises of comparable risk.

E. Weighted Average Cost of Capital

Based upon the foregoing, the Commission should adopt MidAmerican's recommended return on equity of 10.70%, its recommended cost of debt equal to 4.528%, and its recommended capital structure containing 48.270% long-term debt and 41.730% common equity. As shown below, this produces a return on rate base equal to 7.721%:

MidAmerican's Weighted-Average Cost of Capital

December 31, 2012

Capital Component	Balance	Ratio	Cost	Weighted-Average Cost
Long-Term Debt	$3,525,119,950	48.270%	4.528%	2.186%
Common Equity	$3,777,734,285	51.730%	10.70%	5.535%
Total	$7,302,854,235	100.00%		7.721%

VI. Riders

A. Uncontested Transmission Cost Recovery Rider

1. Overview

MidAmerican proposed Rider TS, which is a mechanism for recovering MidAmerican's transmission-related costs from those retail customers that receive power and energy from MidAmerican rather than from alternative retail electric suppliers ("ARES"). MidAmerican Ex. DAS 1.0. The objective of Rider TS is to replicate, for those customers taking bundled service from MidAmerican, the transmission charges the Midcontinent Independent System Operator, Inc. ("MISO") would apply to an ARES serving load in the MidAmerican service area.

Rider TS segregates all transmission costs incurred by MidAmerican into a single charge. *Id.* at 4, ll. 56-57. There are two categories of transmission costs included in the Rider - (1) charges for MidAmerican's Illinois retail load use of the transmission system, including MISO ancillary services charges associated with serving load in a local balancing area, and (2) an allocation of several transmission charges imposed by MISO. Given the current FERC-approved MISO rate schedules, the costs that would be recovered through Rider TS in this second category include: (A) imputed charges under MISO Tariff Schedules 1 and 9, and (B) an allocation of actual charges assessed under Schedules 10, 10-FERC, 26 and 26-A, using the "Non-Specific Plant / Traditional Average and Excess Allocator." In designing Rider TS, MidAmerican followed the general approaches used by Ameren Illinois. Because MidAmerican is a multi-jurisdictional utility, Rider TS allocates a portion of the total charges paid to the Illinois jurisdiction. MidAmerican also proposes an annual reconciliation of Rider TS charges similar to Ameren.

Staff does not object to MidAmerican's implementation of Rider TS as long as MidAmerican excludes all transmission-related costs from its ICC-jurisdictional revenue requirements, as long as FERC only approves reasonable transmission service revenue requirements, as long as the Rider is used to recover only the imputed and actual costs described in Mr. Stevens' testimony, and as long as it is reasonable to use the "Non-Specific Plant / Traditional Average and Excess Allocator" to allocate to Illinois a portion of MidAmerican's incursion of MISO transmission charges, then the Rider will not systematically over-recover the actual transmission costs that are incurred to serve Illinois load. Staff Ex. 9.0 at 4-5, ll. 62-103.

2. <u>Rider TS – Transmission Service Tariff</u>

MidAmerican proposed specific tariff language to implement the cost recovery of MidAmerican's jurisdictional transmission revenues as costs through Rider TS. MidAmerican Ex. DLK 1.0 at 21, ll. 444-448. Staff, however, recommended that Rider TS be revised to include further explanation of the terms, reconciliation proceedings, and adjustments ordered by the Commission among other clarifications. Staff Ex. 1.0 at 7-8, ll. 142-172.

In response to Staff's concerns, MidAmerican changed Rider TS to address Staff's concerns. Rider TS was revised as follows: consistent use of "Rider TS" in the terminology; more clearly describing the requirements for an annual reconciliation proceeding; adding a provision for Commission ordered adjustment through a new factor "O"; specifying three tests to be performed in the internal audit; clarifying time periods listed in Rider TS; and clarifying that factor "C" established for midyear adjustments would be in effect through the following March 31. MidAmerican Ex. DLK 2.0 at 3-4, ll. 56-73. Staff indicated the changes in the revised Rider TS addressed the concerns and that the Commission should adopt Rider TS as revised, if the Commission approves MidAmerican's request to implement Rider TS. Staff Ex 10.0 at 6-7, ll. 121-127.

As outlined above, the implementation of Rider TS is uncontested and produces just and reasonable transmission rates. Accordingly, the Commission should adopt Rider TS as revised by MidAmerican.

B. Uncontested Riders Eliminated

MidAmerican proposed to eliminate several riders in its new tariff. No party objected to the elimination of these riders. The following discussion outlines the riders MidAmerican proposes to eliminate and the reasons for their elimination. MidAmerican Ex. DLK 1.0 at 15-20, ll. 306-408.

1. Rider 3 – Commercial Electric Space Heating

MidAmerican proposes to eliminate Rider No. 3 – Commercial Electric Space Heating since MidAmerican does not provide a separate space heating rate for residential or industrial customers. Further, the existing tariff requires the customer to install wiring to accommodate separate measurement of the electricity used for space heating during the winter months. Consumption measured by such meters for the Company's June, July, August, and September billing periods is included along with other uses at the applicable rate. MidAmerican Ex. DLK 1.0 at 16-17, ll. 332-340.

2. Rider 4 - Interruptible Service

MidAmerican proposes to eliminate Rider No. 4 – Interruptible Service. The current tariff is available only to customers taking service under this Rider No. 4 on May 31, 2008, and no new customers have been allowed to take service under the rider since that date. This rider is very similar to the current Rider 14: Curtailment Services, which is proposed to be replaced by a minimally-revised Rider CS: Curtailment Service. It is reasonable to eliminate this rider since there is no need for two similar riders. MidAmerican Ex. DLK 1.0 at 17, ll. 341-348.

3. Rider 5 – Limited Term Contract Service

MidAmerican proposes to eliminate Rider No. 5 – Limited Term Contract Service. The purpose of this rider is to retain, attract, and expand electricity sales in a manner which allows economic operation by the customer and provides a contribution to the Company's fixed costs. A provision of the rider is that all contracts for service under this rider shall terminate no later than May 15 of the year in which the Company must commit to construct intermediate or base load capacity to serve ultimate consumers and full requirements wholesale service. While

MidAmerican has not constructed base load capacity to serve Illinois customers, MidAmerican has built base load capacity in Iowa. MidAmerican Ex. DLK 1.0 at 17, ll. 349-360.

4. Rider No. 11 – Economic Development

MidAmerican proposes to eliminate Rider No. 11 – Economic Development because this rider has expired. The rider specified that no individual customer term shall be longer than 60 months and no billing adjustments shall extend beyond the December 1999 billing period. MidAmerican Ex. DLK 1.0 at 18, ll. 361-366.

5. Rider No. 13 – Municipal Compensation Adjustment

Rider No. 13 Municipal Compensation Adjustment allows MidAmerican to recover franchises or other government fees or charges from customers within the governmental unit. MidAmerican proposes to eliminate Rider No. 13 because MidAmerican is not currently required to pay any franchise or other government fees or charges and has not used this Rider No. 13 since 1995. MidAmerican Ex. DLK 1.0 at 18, ll. 367-374.

6. Rider No. 15 – Optional Commercial Time of Day Service

MidAmerican proposes to eliminate Rider No. 15 – Optional Commercial Time of Day Service since MidAmerican is proposing separate Time-of-Use rates rather than layering a rider on top of commercial rates. MidAmerican Ex. DLK 1.0 at 18, ll. 375-379.

7. Rider No. 17 - Non-Residential Real Time Pricing

MidAmerican proposes to eliminate Rider No. 17 – Non-Residential Real Time Pricing as MidAmerican is exempt from the legislative requirement to offer this rate. Further, this is an optional rate and no customers have selected this rate in over ten years. MidAmerican Ex. DLK 1.0 at 18-19, ll. 380-385.

C. Uncontested Changes to Existing Riders

1. Energy Efficiency Cost Recovery Factor

MidAmerican proposed to delete Factor E from the calculation and from the definition of embedded costs. MidAmerican Ex. DLK 1.0 at 19-20, ll. 398-435. No parties objected to this deletion of the factor. Accordingly, the revision is reasonable and should be adopted by the Commission.

2. Fuel Adjustment Clause

MidAmerican's rate filing continues the implementation of the FAC. MidAmerican, however, proposes to roll all fuel costs out of base rates and set Factor BFC, base fuel costs, to zero. This change will have no impact on the total, but will provide greater transparency as to total fuel costs paid by the customer. MidAmerican Ex. DLK 1.0 at 21, ll. 436-441.

VII. Cost Allocation and Rate Design

A. Contested Issue

1. The Hourly Costing Model

Introduction – Cost of Service Study

MidAmerican presented a cost of service study to be used in determining rates as required by the Commission's rules. *See* MidAmerican Schedule E-6. MidAmerican first allocated its costs to functional category and then allocated each functional category to customer class. The functional categories identified in MidAmerican's cost of service study are generation, transmission, substations, three-phase wires, single-phase wires, transformers, services, meters, customer accounts and lighting. MidAmerican Ex. CBR 1.0 at 5, ll. 72-85. MidAmerican's cost of service study used the Hourly Costing Model ("HCM") to allocate generation costs, used a 12

Coincident Peak ("12 CP") allocator for transmission costs, a non-coincident peak ("NCP") allocator for substation costs and a split system distribution wires allocator. Weighted costs for transformers, services, meters and customer accounts are included in the calculation of class customer charges. Lighting costs are directly allocated to the lighting classes. *See generally*, MidAmerican Ex. CBR 1.0 at 3-16, ll. 39-351.

<u>HCM Overview</u>

MidAmerican presented evidence supporting the use of the HCM for allocation of generation costs in its cost of service study. The HCM is a method for pricing generation service to retail customers. The HCM prices generation service on a non-discriminatory basis based on customer load shapes and usage patterns, and the cost of acquiring and producing generation at different times of the day and different times of the year. MidAmerican Ex. CBR 1.0 at 8, ll. 138-142.

The goal of the HCM methodology is to assign a price for generation to each hour of the year. *Id.*, ll. 144-145. The generation revenue requirement assigned to each customer class under this methodology results from applying each class' hourly load profile to the hourly price profile generated by the HCM, loads multiplied by prices. MidAmerican Ex. CBR 1.0 at 8, ll. 145-148. The ratio of total generation cost resulting from this cross-multiplication of loads and prices for a single class to the total generation cost for all classes is then used to allocate MidAmerican's generation-related revenue requirements to that customer class. *Id.*, ll. 148-152.

The HCM calculates a generation price for each hour of the year by assigning a cost to each MWh in the retail system load curve. *Id.*, ll. 155-156. For any given hour, the HCM methodology calculates the average of the costs for all MWh in that hour to determine the average generation price for that hour. *Id.*, ll. 156-158. Each MWh in the retail system load curve is assigned a cost that contains two components; an energy component and a capacity component. *Id.*, ll. 161-163.

The HCM is a reasonable cost of service method for pricing generation because of the following reasons:

- The HCM methodology rewards customer groups whose load characteristics, load patterns, and time of use characteristics result in lower costs to serve. Customers and customer groups whose energy consumption is high at times of high system load and high costs pay higher total costs and are allocated more generation costs than customer groups whose load shapes are more favorable.
- The HCM methodology also rewards customer groups with higher load factors. Customer groups with high load factors are allocated a lower generation cost (on a per unit basis) than customer groups with lower load factors.
- The HCM methodology results in pricing for generation services that is non-discriminatory. The HCM results in a single average price for generation service in each hour of the year that reflects both an energy component and a capacity component. All customers that are taking generation service in any given hour pay the same price per kWh under the HCM model for that generation service regardless of size or end use.
- The HCM model is both a de facto cost allocation model and a pricing model. Unlike traditional cost allocation methodologies, results from the HCM model can be used directly in the ratemaking process. Because generation prices are available from the HCM model by hour, prices can be summarized by season or time of use pricing period and translated directly into seasonal and time of use retail rates. This is a feature that is not supported in traditional cost allocation methodologies. In other words, the HCM model is more precise than other models that use broad assumptions to estimate cost characteristics that are subject to variability over the course of a day.
- Results from the HCM model are more stable from year to year than traditional generation cost methodologies because the HCM model considers energy consumption patterns all through the year, as opposed to traditional methods that rely on a single hour's demand reading that can change significantly from test year to test year. Rather than have rates be heavily influenced by a single hour in the year, rates reflect cost causation over all hours of the year.

MidAmerican Ex. CBR 1.0 at 11-13, ll. 227-254.

In its initial filing, MidAmerican based the energy component of each MWh on the MISO Locational Marginal Price ("MISO LMP") for the MidAmerican retail load zone node associated with the hour of the year the MWh is produced. *Id.*, ll. 164-167.

The capacity component of each MWh is determined by the load level the MWh is serving, the number of hours during the year that retail load is at or above that level, and the capacity cost on a $/kW basis used to serve that load level. *Id.*, ll. 177-176.

Staff's Modification to the HCM is Reasonable and Addresses Concerns Raised by Deere and DOD.

Staff proposed to modify the HCM such that the energy component of the HCM reflects retail fuel costs only, as opposed to reflecting the actual value of the hourly MISO LMPs, with all non-fuel generation costs allocated to and contained within the capacity component of the HCM. MidAmerican Ex. CBR 2.0 at 3, ll. 35-39.

MidAmerican agreed with Staff's modification and agreed that the proposed change better segregates retail fuel costs from non-fuel costs in the HCM. This change allocates more costs to lower load factor customers and removes any concerns over the potential double-counting of capacity cost in the energy component of the HCM. MidAmerican Ex. CBR 2.0 at 3-4, ll. 41-46.

In contrast DOD and Deere raise the following four general concerns regarding the HCM. These concerns are summarized as follows:

- The HCM inappropriately uses marginal costs to allocate the energy component of the HCM. DOD MPG 1.0 at 47, ll. 974 – 1000.
- The HCM fails to recognize that higher load factor customers are less costly to serve. Deere Direct at 9, ll. 13-15.
- The HCM over-allocates costs to high load factor customers. DOD MPG 1.0 at 49-50, ll. 1023-1029 and ll. 1042-1046; Deere Direct at 9, ll. 5-7 and at 10, ll. 2-4.
- The HCM produces inefficient price signals which will cause customers to use energy in an inefficient manner, discourage demand management, and artificially establish a

need for new capacity prematurely. DOD MPG 1.0 at 50, ll. 1030-1041; Deere Direct at 10, l. 5 through 11, l. 2.

See generally, MidAmerican Ex. CBR 2.0 at 4, ll. 51-61.

Adopting Staff's Proposed Adjustment to the HCM Appropriately Separates Energy and Capacity Cost Components

The DOD expressed concerns over the use of MISO LMP data in MidAmerican's HCM. These concerns are essentially the same concerns that Staff raised in direct testimony. Staff Ex. 7.0 at 8-12, ll. 164-255. Staff's proposed modification to limit the energy component of the HCM to retail fuel cost only, which MidAmerican agrees with, addresses the DOD's concerns and eliminates concerns over the use of marginal cost data to establish the energy component in the HCM. MidAmerican Ex. CBR at 4-5, ll. 64-69.

Moreover, the use of MISO LMP data as the basis for allocation of energy costs between hours is reasonable because the MISO LMP data is directly related to the cost to MidAmerican of purchasing energy in the MISO market to serve retail customers. MidAmerican Ex. CBR 1.0 at 10, 1l. 202-205. Since MidAmerican is a MISO member and is required to bid its generation directly into the market and also purchase from the market at MISO market prices to serve retail load, it is reasonable to use the MISO LMP data to determine energy prices for customer groups under the HCM methodology. *Id.* at 10-11, 1l. 205-208. Using MISO LMP prices as an allocator in the HCM also helps to ensure consistency between unbundled generation prices offered by MidAmerican and generation prices customers could expect to see from third party suppliers. *Id.* at 11, 1l. 210-213.

Accordingly, DOD's concerns are misplaced and were addressed by modifying the HCM as noted above.

The HCM Recognizes that Higher Load Factor Customers are Less Costly to Serve

Contrary to Deere's contention that the HCM does not recognize that higher load factor customers are less costly to serve, MidAmerican provided evidence that shows a comparison of class average generation costs on a $/MWh basis to class load factors from the modified HCM. MidAmerican Ex. CBR 2.0 at 5, ll. 70-75; MidAmerican Ex. CBR 2.1, Sch. A. MidAmerican Ex. CBR 2.1 shows that with the exception of the lighting class, there is a very clear and distinct relationship between average generation cost and load factor. MidAmerican Ex. CBR 2.0 at 5, ll. 73-81. The correlation between class average generation cost and class load factor is -97%, which is nearly perfect. Consequently, with the exception of the lighting class, customer classes with higher load factors enjoy better generation costs on a per unit basis than classes with lower load factors under the HCM. *Id.*, ll. 79-81.

Accordingly, Deere's contention that the HCM does not recognize the lower cost to serve high load factor customers is incorrect and the Commission should not give any weight to this concern.

<u>The HCM Does Not Over Allocate Capacity Costs to Higher Load Factor Classes</u>

Both Deere and DOD complain that the HCM over-allocates capacity cost to higher load factor classes. Neither Deere nor DOD have offered any objective evidence as the basis for this contention, however. They have not presented the Commission with any alternatives for the HCM to be compared against. As noted above, MidAmerican Ex. CBR 2.1, Sch. A demonstrates that higher load factor customer classes enjoy a better per unit generation price under the HCM than lower load factor classes, excluding lighting customers.[10] Consequently, the HCM is a well-

[10] The lighting class gets a favorable average generation cost from the HCM because the lighting class uses no energy at all during summer on-peak hours. This treatment reflects time of use characteristics, and time of use is a more important determination in the overall cost of generation that a customer class should be allocated than load factor. While classes with high load factors enjoy a favorable average price from the HCM, these classes necessarily have some usage during the summer on-peak period. It is possible for a customer or customer class to

balanced allocation methodology that neither over-emphasizes nor under-emphasizes the allocation of energy or capacity costs to any particular customer class and the Commission should adopt its use.

The HCM Sends Clear Price signals

Deere and DOD further contend the HCM produces inefficient price signals which will cause customers to use energy in an inefficient manner, discourage demand management, and artificially establish a need for new capacity prematurely. Deere Direct at 10, ll. 5 through 11, l. 2; DOD MPG 1.0 at 50, ll. 1030-1041. As MidAmerican demonstrated, however, the price signals under the Modified HCM are clear, unmistakable, and accurate. Customer classes that use high amounts of energy during times of high system load (residential customers, for example) pay the price for that energy and pay relatively high average generation prices under the HCM. Customer classes that use little or no energy during times of high system load (lighting, for example) or that use a large amount of energy during off-peak periods as compared to on-peak periods (industrial classes, for example) enjoy favorable pricing under the HCM. MidAmerican Ex. CBR 2.0 at 7, ll. 125-129.

MidAmerican provided a summarization of the hourly costs against which the load shape for each customer class is applied to determine class generation costs. *Id.*, ll. 114-116. The distribution of prices below demonstrates that the Modified HCM values energy during summer on-peak periods at a significantly higher rate than during the off-peak periods. *Id.*, ll. 116-118. This is especially true during the hours where the system load is highest. During times of high

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have a relatively poor load factor with usage that is exclusively off-peak. This customer (or customer class) causes less capacity cost on the system than a higher load factor class with more usage on-peak. The HCM recognizes this reality; whereas most demand allocators do not. *See* MidAmerican Ex. CBR 2.0 at 5-6, ll. 85-96.

system load, the cost of energy under the Modified HCM is more than twelve times higher than during off peak periods. *Id.*, ll. 119-121.

Period	**Average Load (MW)**	**Energy Component ($/MWh)**	**Capacity Component ($/MWh)**	**Total Price ($/MWh)**
Top 100 Load Hours	420	$50.78	$281.80	$332.58
Summer On-Peak Hours	313	$26.54	$55.24	$81.78
Summer Normal Hours	280	$20.84	$39.32	$60.16
Summer Off-Peak Hours	221	$10.39	$19.84	$30.23
Winter Normal Hours	230	$16.00	$17.47	$33.47
Winter Off-Peak Hours	193	$10.95	$15.41	$26.36

Moreover, the Iowa Utilities Board ("IUB") also recognized that the HCM sends price signals that accurately reflect the completive electric market. While MidAmerican recognizes IUB's decision is not binding on the Commission, the IUB's recent decision is nonetheless instructive. The IUB recognized the HCM's cost causation and explained:

> The proposed Settlement modifies the HCM method developed by MidAmerican in response to intervenors' comments so that costs are allocated separately for energy and demand, calculating hourly costs for capacity and energy for the entirety of the test year. These costs are a function of the total system load, which results in higher costs during hours of peak demand. Deere and IICAP point out that for a particular hour, if only the residential load increases, all customer classes experience a higher energy and capacity cost for that hour. While Deere and IICAP maintain that this is not fair, it does closely resemble the way in which competitive markets work—during hours of high demand, all customer classes must pay higher prices, not just particular customer classes.

In Re: MidAmerican Energy Company, IUB Docket No. RPU-2013-0004, Order Approving Settlement, with Modifications, and Requiring Additional Information at 79 (March 17, 2014) and Order on Rehearing (July 10, 2014).

Additionally, Staff also agreed that by using MISO LMPs and weighted capacity costs for all hours in the year, more accurate market-based information is reflected in the HCM allocator, which in turn reflects more accurate costs to serve customers for every hour. Staff Ex. 7.0 at 11, ll. 235-239.

Conclusion

MidAmerican's HCM as modified, and accepted by Staff is a reasonable cost of service allocation for generation. The HCM accurately reflects how MidAmerican incurs costs to serve customers. As has been demonstrated, the HCM allocates costs consistent with cost causation principles that accurately reflect the competitive wholesale market. The HCM recognizes that MISO membership has changed how MidAmerican incurs generation costs, and it accurately allocates those costs. The evidence supports the reasonableness of the HCM to allocate generation costs and it should therefore be adopted by the Commission.

B. Uncontested Issues

1. Single-Phase and Three-Phase Split System Methodology

MidAmerican originally proposed to include a split distribution allocation for single and three phase distribution. MidAmerican Ex. CBR 1.0 at 14, ll. 283-308. Staff, however, proposed an alternative allocation employing a single non-coincident peak ("NCP") demand allocator for all distribution wire costs. Staff Ex. 7.0, ll. 59-61. Staff based its recommendation on recent Commission decisions and Staff's familiarity with MidAmerican's Illinois distribution system.

MidAmerican agreed with Staff's recommended NCP allocator for distribution wire, with the exception that the Very Large General Service ("VLGS") class not be allocated distribution wires. MidAmerican Ex. CBR 2.0 at 8, ll. 142-151. MidAmerican testified that all four customers in the VLGS class take service directly from a distribution substation and are responsible for very little distribution wires costs on MidAmerican's system, if any at all. Therefore, it is not reasonable to allocate distribution wires cost to these customers. MidAmerican Ex. CBR 2.0 at 8, ll. 144-151.

Based on the foregoing, the Commission should approve the NCP allocator for distribution wires to all customer classes except the VLGS customers.

(i) Transmission Cost Allocation

The use of the 12 CP methodology to allocate transmission costs has not been contested. The 12 CP allocator is reflective of MidAmerican's transmission costs, as MidAmerican is assessed for transmission costs monthly by MISO on a load ratio share basis. MidAmerican Ex. CBR 1.0 at 13-14, ll. 259-282.

2. Rate Design

Staff and MidAmerican agree that MidAmerican's cost of service study appropriately functionalizes and allocates costs to customer classes. Staff recommended that MidAmerican's basic service charges reflect the cost of service. Staff Ex. 7.0 at 14, ll. 309-306. MidAmerican accepted Staff's recommendation to set the basic service charge at cost of service, resulting in a residential basic service charge of $7.75. MidAmerican Ex. CBR 2.0 at 9, ll. 157-170.

3. Weather Normalization

MidAmerican proposed a weather normalization pro forma adjustment designed to determine a level of retail sales and revenues under existing rates that could be reasonably expected given normal weather conditions, thus eliminating the effect on test year retail sales and revenues of having unusually mild or extreme weather during the test year. MidAmerican estimated that about 32% of electricity sold to residential customers and about 12% of electricity sold to commercial customers is used for cooling and heating and is therefore weather dependent. MidAmerican Ex. CBR 1.0 at 19, ll. 393-395. As a result, the level of annual revenue that is collected from volumetric charges associated with this electricity usage is dependent on how hot or mild the summer season is, and how cold or mild the winter season is. Hot summers and cold winters will result in MidAmerican collecting a higher level of revenue than it normally otherwise would, and mild summers and winters will result in MidAmerican collecting a lower level of revenue. *Id.*, ll. 395-401.

Accordingly, MidAmerican proposed weather normalization pro forma adjustments for the Residential, Small General Service – Energy, and Small General Service – Demand customer classes. MidAmerican Ex. CBR 1.0 at 19, ll. 391-425. The weather normalization pro forma adjustment reduces total test year revenue by $891,839.[11]

No party took issue with how MidAmerican's weather normalization pro forma was determined. MidAmerican's weather normalization is consistent with Commission rules and therefore it is reasonable for the Commission to adopt MidAmerican's recommend weather normalization pro forma adjustment.

4. Unbundled Bill

MidAmerican proposed to unbundle its bill to set out various elements of the bill separately in the following categories:

- Basic Service Charge
- Meter Service Charge
- Supply Charge
- FAC

[11] The weather normalization pro forma adjustment for both revenue and kWh sales by class is provided in MidAmerican Ex. CBR 1.1, Schedule F and in the filing requirements at Section 285.5025 Schedule E-4 (a) (2), and MidAmerican's methodology for determining the revenue component of the weather normalization pro forma adjustment is also provided in in Schedule G; *See also* MidAmerican Ex. CBR 1.0 at 20, ll. 413-416.

- Delivery Charge
- Transmission Service Charge
- Taxes and other surcharges.

MidAmerican Ex. DLK 1.0 at 23-24, ll. 491-517.

No party took exception to the unbundling of MidAmerican's bill. MidAmerican requests the Commission approve its new bill format.

VIII. Tariff Revisions

A. Uncontested Miscellaneous Tariff Issues

1. Tariff Reorganization

MidAmerican's proposed electric tariffs contain a complete revision of the four existing Illinois electric tariffs. MidAmerican proposes to combine all four tariffs for these services into a single tariff and to cancel Schedule of Rates for Electric Service in Illinois, Ill. C. C. No. 1; Schedule of Rates for Electric Delivery Service in Illinois, Ill. C. C. No. 6; Schedule of Rates for Supplier Electric Delivery Service in Illinois, Ill. C. C. No. 7; and Schedule of Rates for Supplier Metering Service in Illinois, Ill. C. C. No. 8 and replace them with a new single MidAmerican Energy Company Rates for Electric Service in Illinois, Ill. C. C. No. 10. The proposed electric tariff consolidates the terms and conditions, rules and regulations, and rate schedules for all services and provides a single table of contents. This reorganization will make it easier for customers, suppliers, employees and regulators to use MidAmerican's tariff. The organization of the electric tariff will now be consistent with MidAmerican's gas tariff previously approved by the Commission in Docket No. 09-0312. MidAmerican Ex. DLK 1.0 at 3-15, ll. 38-305.

Rate Elimination

MidAmerican proposed to eliminate two rates. Elimination of Rate 9 was proposed for administrative efficiency. A relatively small number of customers qualify for the rate each year, but resources are required to review each residential account each year. Additionally, it can be confusing for customers to be switched back and forth from Rate 9 to Rate 10 from year to year. MidAmerican Ex. DLK 1.0 at 16, ll. 321-323. MidAmerican also proposed to eliminate Rate 45 – Municipal General Light and Power as separate load information is not available for Rate 45 accounts; they are included with the commercial load sample. Municipal accounts will be moved to the appropriate commercial or industrial rate. MidAmerican Ex. DLK 1.0 at 16, ll. 328-331. No party opposed the elimination of these two rates.

2. Reconnection Fee

MidAmerican proposes to update charges for reconnection following a disconnection of service. Tariff No. 1 currently includes a charge of $25 for reconnection at the meter after disconnection for non-payment. This charge has been in place since 1995. MidAmerican proposes to adopt a time and materials charge for reconnection of service. Consistent with Commission rules, one reconnection charge per year will be waived. MidAmerican Ex. DLK 1.0 at 8, ll. 142-147.

3. Refunds for Billing Adjustments

Staff recommended that MidAmerican's proposed refund language be revised to allow a period of two years for refunds for all customers to be consistent with the Act. Staff Ex. 7.0 at 24-25, ll. 525-544. MidAmerican agreed with Staff's recommendation and noted the original language was an inadvertent error. MidAmerican Ex. DLK 2.0 at 3, ll. 38-44.

4. Changes to Definitions

Staff recommended that any definitions that are currently contained in MidAmerican's Rate Schedules, Clauses, and Riders not be removed as proposed. Staff Ex. 7.0 at 3, ll. 62-63 and at 24, ll. 516-524. MidAmerican agreed to retain the definitions in those sections of the electric tariff. MidAmerican Ex. DLK 2.0 at 3, ll. 46-54.

B. Uncontested Non-Substantive Tariff Changes

MidAmerican proposed the following non-substantive tariff changes to electric tariff Ill. C. C. No. 10. Following the filing of this rate case, several typographical and grammatical errors were discovered.[12] MidAmerican Ex. DLK 2.0 at 10-11, ll. 195-206. MidAmerican revised Tariff Sheet No. 469 to reflect the requirement for the Rider EECR charge to be a separate line item as required by the final order in Docket Nos. 13-0423 and 13-0424.

Additionally, Sheet Nos. 364 and 365, which show the residential bill form, were updated to reflect the separate line item for Rider EECR. *See* MidAmerican Ex. DLK 2.1, Sch. F and C. MidAmerican Ex. DLK 2.0 at 10, ll. 195-206.

IX. Conclusion

For the reasons set forth above and reflected in the record, MidAmerican Energy Company respectfully request that the Commission accept the uncontested positions and determine that MidAmerican's positions on the contested issues are reasonable, consistent with Illinois law, and MidAmerican's rate application, as revised, be adopted in setting final electric rates.

[12] Tariff Sheet Nos. 15, 16, 40, 47, 53, 89, 94, 116, 194, 198, 209, 221, 261, 262, 265, 293, 354, 381, 400, 415, 424, 436, 438, 464, 490 and 493 were revised to correct those errors.

WHEREFORE, MidAmerican Energy Company respectfully requests that the Illinois Commerce Commission issue an Order approving MidAmerican's rate application.

DATED this 22nd day of July, 2014.

Respectfully submitted,

MIDAMERICAN ENERGY COMPANY

By ___*/s/* ___ *Steven R. Weiss*__________________
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